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PREFACE

IN part, this number of the PROCEEDINGS of the Academy of Political Science has already become important in " The Voice of America "; for the speeches of Paul G. Hoffman, George F. Kennan and Thomas S. Lamont at the dinner session were recorded for use in broadcasts overseas. Much that appears in these pages, therefore, has reached a far larger audience than that which heard the program in the Hotel Astor, on November 10, 1949.

For Western Europeans, as well as for Americans, the theme of the Academy's Sixty-ninth Annual Meeting has a special timeliness. The rate of recovery in the European economy will affect favorably or adversely vital sectors of the American economy. In the countries participating in the plans of the Organization for European Economic Co-operation there are encouraging signs—notably the production increases—but the existing barriers to the exchange of goods and services in the world's markets make it uncertain whether Europe by 1952 can attain anything more than " a precarious balance ". Such a status would mean failure for the great coöperative effort which started with the announcement of the Marshall Plan. Much remains to be done, if Europe is to become " independent of extraordinary outside assistance ". In the following papers, suggestions concerning future policies are presented and critically examined, in an attempt to indicate the lines along which international coöperation should proceed toward the goal of world peace.

The Academy here records its gratitude to the participants in the public forums which made this issue of the PROCEEDINGS possible.

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INTRODUCTION

LEO WOLMAN, *Presiding*
Professor of Economics, Columbia University
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THE Academy, in its sixty-ninth year, welcomes its members and friends to this morning session. The subject for discussion today and this evening is a report on the progress of European economic recovery and the part played in this recovery by the American recovery program. It is my pleasure to introduce the first speaker who will talk on " European Economic Recovery: Progress and Problems ". He is Professor Arthur Robert Burns, Professor of Economics at Columbia University.

EUROPEAN ECONOMIC RECOVERY: PROGRESS AND PROBLEMS

ARTHUR R. BURNS
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ECONOMIC relations between the United States and Europe have been a recurring problem since the end of the war. In 1946 the United States made loans to enable European countries to clear away the debris of war. These loans proved inadequate, and we proceeded to more comprehensive aid in loans and grants under the Marshall Plan. Now we ask whether European recovery is in sight. Much has been said and written on the subject, but I will try to outline the problem. I shall rely on broad generalizations and say little about the problems of particular European countries except by way of illustration. I shall have chiefly in mind the countries of Western Europe since it is with these that we are most concerned in relation to the Marshall Plan. The presentation of a broad picture has been much facilitated by the reports of the United Nations Economic Commission for Europe, upon which I shall lean heavily.

European recovery has made remarkable progress since the war ended. The aggregate production of agricultural and industrial commodities is estimated (though the estimates are admittedly subject to a considerable margin of error) to have increased between 1947 and 1948 by some $5 billions (in prewar American prices) which is nearly 15 per cent, or, if Germany is excluded, about 12 per cent. But production had not recovered to its pre-war level. Commodity output was still 11 per cent below 1938. Most of this decline in output is accounted for by Germany. In the remainder of Europe output was 7 per cent above 1938, two thirds of this increase being accounted for by the United Kingdom.[1]

This recovery has proceeded at different rates in industry and agriculture. In 1948 the industrial output of fifteen countries,

[1] United Nations Economic Commission for Europe, *Economic Survey of Europe in 1948,* p. 20.

which before the war accounted for four fifths of the industrial production of Europe, was 4 per cent below their 1938 production. But if Germany is excluded, the fourteen countries were producing 13 per cent more industrial goods than in 1938. Russia (not included in these figures) was producing 18 per cent more industrial goods in 1948 than in 1938.[2] Anticipations late in 1947 that the rate of improvement would level off have not been fulfilled.[3] European agricultural production, although it has increased since the end of the war, is still 15 per cent below the average output from 1934 to 1938 (or, if Germany is excluded, 10 per cent below output before the war).[4]

These increases in production have not been achieved solely out of European resources. European countries paid with exports, visible and invisible, for 62 per cent of their imports in 1948, compared with 48 per cent in 1947. In their dealings with the rest of the world, European countries, after allowing for price changes since 1938, were importing 7 per cent more than in 1938 and exporting 5 per cent more.[5] But to pay for all their imports, they would have to increase their exports 55 per cent at constant prices. The balance has been covered by sales of gold and foreign assets and by United States aid. The adverse European balance on foreign account was $7.6 billions in 1947, and the United States provided $4.9 billions in long-term loans and donations to which should be added most of the $1.2 billions obtained through U.N.R.R.A., the International Bank, and the International Monetary Fund. In 1948 the aggregate

[2] *Ibid.*, p. 4. Most European countries have been improving industrial output at the rate of 10 to 20 per cent per year since 1946.

[3] The United Kingdom produced in 1948 about 21 per cent more industrial goods than in 1938 and France 8 per cent. Only Germany, Greece and Italy were producing less than in 1938, and in some countries there were very marked gains over 1938; for instance, in Bulgaria 70 per cent, Sweden 43 per cent, Ireland 37 per cent, Poland 33 per cent and Denmark 30 per cent. *Ibid.*, p. 4.

[4] The United Kingdom production was 15 per cent above output before the war, Turkey 25 per cent, Sweden 5 per cent; Denmark and Switzerland were producing about as much as before the war and other countries less (particularly Germany, Poland and Belgium which all produced about 30 per cent less).

[5] Exports of manufactures from Europe have already returned to prewar level despite the virtual cessation of German exports of this type.

adverse balance was $5.6 billions, of which United States aid covered about $4.8 billions.[6] Progress is also being made, therefore, in balancing Europe's accounts with non-Europeans. The over-all adverse balance has fallen over 35 per cent, but it remains large.

The present problem is to find ways by which Europe can, soon, be reasonably self-sustaining with a standard of living at least not much lower than at present. Wide disparities among countries in their material conditions of living place difficulties in the way of mutually advantageous political and economic equilibrium. At the present time any solution involving serious reduction in West European standards of living is likely, by endangering the existence of the present types of government in Western Europe, to undermine the present foreign policy of the United States.

It was rather widely assumed at the end of the war that the European economic problem was mainly one of replacing wartime losses of the means of production both in agriculture and industry, refilling pipe lines of working capital, tiding over the reconversion from war to peace (including military demobilization, recovery from the disorganization of production, and the cessation of Lend-Lease), all important in varying degrees in different countries. At that time we probably underestimated the magnitude of even these tasks. In addition, the burdens of war have been very unequally distributed. Some countries, notably the United Kingdom and Holland, have lost sources of overseas income which have left serious gaps in their means of paying for imports. In 1938, "invisible" items paid for 40 per cent of British net imports compared with 5.5 per cent in 1948. But, now that production and trade have made so much progress, we scan the pattern of revival for signs of diminishing need for aid from the United States.

The pattern of revival has involved a diversion of some formerly intra-European trade toward non-European countries, and particularly to the United States. Intra-European trade is about 30 per cent below its volume in 1938, chiefly owing to the small volume of German and Austrian foreign trade. The revival of Germany and Austria, although it might reduce the

[6] United States aid was, however, equivalent to only 4 per cent of the goods and services available in Europe.

present dollar shortage, presents special problems even more disturbing than those of the rest of Europe.

Europe has also suffered since the war from a complex of adverse price changes. European countries had to export about 10 per cent more goods and services in 1948 than in 1938 to pay for a given volume of imports. Ninety per cent of the imports of European countries from outside Europe in 1948 consisted of food, fuel and industrial raw materials. Of their exports to non-European countries in 1948 about 70 per cent consisted of manufactures. Between 1946 and 1948, the prices of overseas imports have risen 37 per cent while the prices of their major exports have risen only 19 per cent,[7] and " the adverse effect on the trade balance of the deterioration in Europe's terms of trade between 1947 and 1948 was thus in the neighborhood of $1 billion." [8] These figures relate to only a short period of time but they raise the question whether present conditions are likely to persist. It is discouraging to find that, had exports and imports been traded at current United States prices, the terms of trade would have deteriorated 27 per cent between 1938 and 1948 rather than the 10 per cent which they did in fact deteriorate.[9] The United Kingdom, for instance, has somewhat protected itself by buying food and raw materials on long-term bulk-purchase contracts, but the margin of this protection has been shrinking. Although European export and import prices may not adjust to present American prices (which are themselves subject to considerable change), American influence on prices in world trade is important especially as European exports come to be sold in buyers' markets rather than the sellers' markets which they have been enjoying.

The reason European prices have risen more than United States prices for the same type of goods may be that European currencies have (until recently) been overvalued in relation to the dollar (or that the dollar has been undervalued in relation to all other currencies). But it is more likely that present difficulties arise from causes more fundamental than a failure to ad-

[7] In 1948, European imports cost roughly $800 million more in current prices than in 1947, although their volume fell about 6 per cent. The total value of exports rose about 35 per cent, but the unit value of these goods rose only about 4 per cent. Economic Commission for Europe, *op. cit.*, p. 113.

[8] *Ibid.*, p. 113.

[9] *Ibid.*, p. 100.

just exchange rates to internal inflations manifested in rising prices and wages. Nevertheless, in view of the rigidity of production costs, especially labor, West European countries recently decided that it is easier to devalue currencies than to reduce costs directly. It is difficult to forecast the effects of these devaluations. To take the United Kingdom as an example, British manufacturers seeking to increase their sales in the United States can reduce their dollar prices without reducing their sterling proceeds. But they are not compelled to do so, and would be unwise to do so, where they could not meet any additional demand that might result from price reductions. They may not do so if they expect that American competitors will succeed in persuading Congress to obstruct increased imports or if they expect American competitors to meet their prices (except where total sales of the product are expected to increase considerably). The reactions of American producers will depend partly upon the extent of their unused capacity. In any event, the United Kingdom will increase its acquisition of dollars only if sales of British goods expand proportionately more than dollar prices are reduced.[10] Devaluations of the pound may similarly help British to undersell American exporters in third countries.[11] The devaluation will, on the other side, increase the cost in European currency of imports from the United States. So far as these imports continue, they must raise the cost of production for both export and home consumption. The London *Times* has estimated that the British index of the cost of living will eventually rise about 7 per cent. A rise in the cost of living will generate demands for increased wages, more particularly because it comes at a time of full employment and low real incomes. If conceded, these wage increases will raise the cost of production and tend again to reduce exports.

If the immediate effects of devaluation are not easy to calculate, the more distant repercussions are even more difficult.

[10] If the demand for imports in this country were inelastic, exporting countries could expand their exports at the expense of home consumption without obtaining any extra dollars.

[11] Where these countries have devalued their currencies as much as the British, the price of American imports will in general be increased; where they retain the old value for their currency, the price of British imports in local currency can be reduced.

If methods of production remain unchanged it is doubtful whether these devaluations will succeed except through a reduction in real incomes in Europe resulting from reductions in real wages and home consumption to permit greater exports. The measures announced by the British government on October 24, 1949 included reductions in food subsidies, increases in the cost of school meals and school transport, and a charge for medical prescriptions, all of which will raise the cost of living and tend to reduce the resources used for home consumption. These increases are not great. It is unlikely, however, that serious reductions in the standard of living will be politically feasible.

The efficiency of production in Europe appears, therefore, to be the basic consideration affecting the present unbalance in United States-European economic relations. Output per industrial worker has increased considerably in most European countries since the war ended; [12] and if these increases continue they will help to eliminate the dollar shortage. The more important question is whether productivity has risen or is likely to rise enough to enable Europeans to export in competition with United States producers. Wage rates in most European countries, after allowance for changes in exchange rates, have risen less than in the United States since 1938. But in the United States (where the war involved only minor economic burdens) productivity has risen faster than in Europe (about 30 per cent in output per worker between 1938 and 1947) with the result that there is now a wider margin between productivity in the United States and in Europe than in 1938. In 1948 the productivity of labor in European industry was about one quarter and in European agriculture of the order of one sixth of that in the United States.[13] Even recovery to the relative positions

[12] In England industrial output per worker in 1948 was 8 per cent above 1938, but in Sweden, Finland and Bulgaria the increase was about 16 per cent. In France, Czechoslovakia, Poland, Belgium and Denmark, productivity in industry was about at the pre-war level and in some ten countries it was less than before the war. Economic Commission for Europe, *op. cit.*, p. 7.

[13] *Ibid.*, p. 226. The United States produced in 1937 about 75 per cent as much industrial goods as Europe but 133 per cent in 1948. In fact between 1870 and 1948 Europe's share of world manufacturing production fell from 68 to 25 per cent. *Ibid.*, p. 23.

in 1938 would not have balanced accounts between Europe and the United States. In a lesser degree a similar problem exists within Europe where the gap between the western and the eastern countries is also wide.[14]

These wide disparities in productivity are by no means wholly a result of war, although they have widened since 1938. Productivity has for thirty years or more been rising faster in the United States than in Western Europe. During a considerable part of the nineteenth century the United Kingdom enjoyed a similar relative increase in productivity, but it did not give rise to a " sterling shortage ". The need of the United Kingdom to import food and materials and its investments abroad resulted in a fair balance on its international accounts. The United States is much more self-contained. The decline of relative productivity in Europe was masked for some time between the wars by the low price of agricultural imports, and more recently by American gifts and loans. But some European countries must now export more, merely to make up for wartime losses of foreign investments, at a time when the terms of trade are to their disadvantage, and private foreign lending from the United States has almost ceased.

Higher levels of cost in one country than in another do not prevent balanced foreign economic relations. Comparative, rather than absolute, real cost differences ultimately regulate the international division of labor. But a narrowing of differences in productivity between the United States and Europe is essential to the removal of the present economic unbalance. Productivity in Europe might be increased by improved equipment, better management, more effective use of labor power or shifts of resources from less to more productive sectors.

Improved equipment calls for increased investment, which diverts resources from immediate exports. Thus solution of the immediate problem conflicts with a longer-run solution. Nevertheless most European countries have increased their capital goods since the war to make up for obsolescence, as well as wear, and war destruction. In 1948, net investment in fixed capital

[14] Commodity (industrial and agricultural) output was in 1946 about $197 per head (U. S. dollars of 1938 purchasing power) in Northwestern Europe, $146 in Western Europe, $88 in Central and Northeastern Europe, and $50 in South and Southeastern Europe. *Ibid.*, p. 20.

in Europe (excluding Germany) was about $5 billions which was about half as great as in the United States,[15] and, of this investment in Europe, 36 per cent was made in the United Kingdom and 13 per cent in France.[16] This capital construction was about equal in amount to United States aid. It is well to remember that recent investments have probably not yet had time to produce their full effect on costs and exports.

Immediately after the war many countries were also compelled to allocate part of their output to restoring their working capital. These efforts, however, are virtually completed and, indeed, are one of the reasons for increases in production in the last year or two.

The difficulties of the United Kingdom have been increased by the extent of its unrequited exports. In 1948 the United Kingdom repaid sterling liabilities (or exported capital) to other countries of $844 millions which was not much less than the aid received from the United States. These exports are likely, however, to be reduced in the immediate future.[17]

Although capital formation appears to be about one-quarter higher in 1948 than in 1938, it is still relatively low and, as is to be expected, it is higher in the more developed than in the less developed countries, which means widening disparity in the supplies of capital in different parts of Europe. The economy measures announced by the British government on October 24, 1949 included a reduction of about 7 per cent in the capital-investment program.

The improvement of management presents the most serious yet the most intangible problems, even of definition. Failure to modernize has not been evident everywhere in Europe by any means. Where modernization has lagged the lag has often been due to the uncertainties of the future (especially in England

[15] *Ibid.*, p. 47.

[16] There were also considerable increases between 1938 and 1948 in the proportion of national income invested in fixed capital in Norway, Yugoslavia, Denmark and France. Investment in fixed capital per head of the population was higher in 1948 than in 1938 in Norway, Sweden, United Kingdom, Denmark, France, Yugoslavia and Poland. As investment has characteristically fluctuated a good deal from year to year, these comparisons must not be interpreted too narrowly.

[17] Speech of Sir Stafford Cripps in the British House of Commons, printed in *New York Times*, October 27, 1949.

which is so dependent on foreign markets and, therefore, upon the commercial policies of other governments). It is also attributable to the spread of industrialization which by destroying some export markets and creating others calls for considerable structural changes in the economies of countries like the United Kingdom. But perhaps the main difficulty has been that the relatively large labor supply in relation to resources has resulted in a low level of wages, which has encouraged production based on a larger element of craft activities and lower capitalization than in the United States. As in the United States, labor unions have, particularly in England, often impeded efforts to reduce costs out of fear of unemployment. In these circumstances the incentives to improved management and risk-taking are important.

Nationalization of industry, and the fear of it, are sometimes blamed for Britain's slow progress in balancing its transactions with the United States. This contention cannot, however, be justified. The London *Economist*,[18] no philanderer with nationalization, has remarked that, without it, coal would probably have been scarcer and dearer, and railway rates higher. Even the threat of nationalization does not appear so far to have seriously discouraged the steel industry, the production of which has risen from 12.9 million tons of crude steel in 1946 to 15.1 in 1948, compared with an average of 11.9 million tons in 1937-38. The steel industry may even have been put on its mettle by the attacks on it.

There is no means of showing that nationalization will impede Britain in its efforts to pay its way in the future. The boards responsible for nationalized industries may be too lenient in dealing with demands for higher wages and so exert upward pressure on wages and prices generally, causing a diversion of resources to the internal market and away from exports. Whether these things *will* happen we do not know. The most important question is whether nationalized industries will be more productive than they would have been under private management. Here again we have the flimsiest of evidence. There is general agreement that productivity in the coal industry can hardly be lower than it would have been without nationalization. What will happen in other nationalized indus-

[18] August 13, 1949.

tries is less certain. But, if it is true that Britain has suffered in recent years from inadequate investment in modernization partly because the prospects of profit have been too uncertain to appeal to private business, the state alone may be willing to accept these uncertainties. The nationalization of the more important industries provides the state with a means of operation. The state, however, must still face the conflict among investment, current exports and the rising demands for consumption goods.

Taxation and public welfare activities may affect the incentives to recovery both directly and indirectly. Taxation can be used to throw upon the higher income groups the burdens resulting from the export of a greater proportion of the national output than previously. But a number of European countries (France being a notable exception) have, in fact, increased taxation also to bring about a redistribution of income, partly in the form of social services. It has been argued that these services, admittedly desirable, should be regarded as a way of garnering the fruits of progress, but not be allowed to divert resources from investment to improve productivity or efforts to pay one's way in international trade. The real question is whether, after taking account of the welfare activities of the state, an excessive proportion of the national resources is being applied to domestic consumption or investments facilitating domestic consumption. Whether the services and goods are bought on the market, or supplied by the state, is of secondary importance. It is not possible to answer this question until we define "excessive", which is a problem for European governments who realize that political and industrial unrest can seriously interfere with recovery.

Welfare programs aimed at income maintenance are internal transfers. In times of unemployment, unemployment benefits enable the unemployed to make larger claims on the national resources than would otherwise be granted. But, even in England where the welfare programs are most comprehensive and liberal, virtually no unemployment benefits have been paid in recent years. Considerably increased benefits have been given to the aged and these are likely to be a perceptible drain on England because the population is aging. This aging of the population is more likely to affect productivity than the type

of provision made for the aged. The principal change in income-maintenance provisions in France and some other Western European countries has been the granting of children's allowances. But these have been a means of granting differential increases in wages and have not resulted in a redistribution at the expense of managers and risk-takers. Workers in France are in fact receiving a considerably smaller proportion of the national income than in 1938 even when welfare benefits are added to wages.[19]

Welfare programs providing services do make demands on the national resources. The plans for education and health services in England, however, have probably as yet diverted relatively little from export production. Expenditure on buildings has been relatively small. The common complaint of the medical profession in England has been that the promised health centers have not materialized. Education and health services have not been so much increased in volume, as redistributed. The available personnel is being spread thinner to the detriment of the amount and quality of service previously received by the upper and middle classes. Housing expenditures have been much less than planned, and a large part of them was an inevitable consequence of war. Furthermore, education and, particularly, health expenditure (including the criticized free provision of eyeglasses) is, at least in part, an investment that will increase productivity. But, like other investments, it may impede payment for present imports, although with intent to improve the means of doing so later. It is possible, however, that the highly progressive taxation resulting in part from the redistribution has left insufficient rewards in freely disposable income to stimulate managers, risk-takers and workers of overtime. The London *Economist* may be correct in saying that the British have "ignored these repercussions just at a time when the situation of the country required that more attention than usual should be paid to them." [20] The economy program announced by the British government on October 24 has now provided for a reduction of expenditures on housing and school buildings.

Expenditure on defense also involves a diversion from con-

[19] Laroque, Pierre, "From Social Insurance to Social Security: Evolution in France", *International Labour Review,* LVII, 588 (1948).

[20] August 13, 1949.

sumption or productive investment. Fourteen European countries spent on the average 7 per cent of their national income on defense in 1938 but only 5 per cent in 1948.

A shift of resources from the less to the more productive sectors of European countries would improve their position. The Western European countries realize that their economy is of a shape which does not fit into the present pattern of world activity. But structural changes often require new investment. They also require estimates of the future pattern of international division of labor, which depends not only on comparative costs, but also upon the policies of governments and the prospects of war. Uncertainties as to these matters place special hazards in the way of countries seeking to reallocate resources to improve their exports. These hazards are particularly serious for the United Kingdom. European countries are trying to shift resources. But the pattern they are following raises many doubts although, as I have just said, we lack criteria for judgment. There is a general tendency toward greater industrialization, particularly in the expansion of the metal and engineering trades and textiles, but little indication of a balanced development for Europe as a whole.[21] These movements toward a balanced development of economies within each national boundary may reduce increases in productivity and deteriorate the terms of trade. There are indications of the recognition that increased agricultural development may be wise, and England and France are moving in this direction. But this move may lead to more subsidies to American agriculture to facilitate agricultural exports from the United States.

In conclusion, the position may be summarized in a few propositions; namely: (1) Pressures upon Western European countries compelling them to dispense with United States aid by severely reducing their standards of living are not in the interest of the United States. (2) Indefinite economic dependence of Western European countries on the United States is in the interest of neither the United States nor Western Europe. (3) Structural adjustments in Western European economies reducing the gap between productivity in Europe and the United States are a primary prerequisite for more satisfactory economic relations. Adjustments have been and are being made, but there

[21] Economic Commission for Europe, *op. cit.*, p. 51.

are limits to the speed with which such changes (some of them long delayed) can be effected, and the present political atmosphere of Europe is not helpful. (4) Pressures resulting in reduced investment may delay a satisfactory adjustment of relations between the United States and Western Europe, but pressures inducing the economical allocation of investment funds will facilitate the achievement of a better relation. (5) The provision of incentives to management and risk-takers presents a difficult problem when a nation is in straitened circumstances, and a considerable part of the population is doubtful as to the past performance of private enterprise, and the necessity for, and equity of, the distribution of incomes that has prevailed in the past. It is unwise to obstruct all experimentation with alternatives to uncontrolled private enterprise. (6) Economic and political uncertainties seriously inhibit success in emerging from the aftermath of war. The European countries need assurance that the United States will maintain stable production. (7) Impediments to imports into the United States and the direct or indirect subsidization of exports are inconsistent with attempts to eliminate the dollar shortage. (8) The rest of the world is less able than the United States to provide the investment funds necessary to narrow present international economic inequalities. These funds must come in the immediate future from exports of American capital in some form.

At this point I enter upon the implications of European recovery for the United States and as this topic will be discussed at a later session, I will not pursue it here.

Remarks by the Chairman

Chairman Wolman: Thank you, Professor Burns.

Our next speaker comes from a neighboring center of learning and was asked to discuss what most people consider to be a very important question, "Obstacles to Multilateral Trade in Europe".

I can think of no one better qualified to deal with this subject, and it gives me great pleasure to introduce the Professor of Economics and Social Institutions at Princeton University, Friedrich A. Lutz.

OBSTACLES TO MULTILATERAL TRADE IN EUROPE

FRIEDRICH A. LUTZ
Professor of Economics and Social Institutions, Princeton University

EUROPEAN foreign trade at present does not by any means proceed exclusively in bilateral channels, and it seems necessary to give a short description of the pattern of European trade before discussing the obstacles which prevent further progress toward the goal of full multilateralism. But first I must define the concepts of bilateral and multilateral trade. Bilateral trade means that each of the two countries involved in this type of trade can use the proceeds of its exports to the other country only to buy in the latter. This leads, provided no capital movements take place between the two countries, to bilateral balancing of trade, exports tending to equal imports between pairs of countries (where the term " export " stands for all credit items, and the term " import " for all debit items in the balance of payments on current account). In a system of multilateral trade, on the other hand, a country can use the proceeds of its exports to another country to buy in third countries so that triangular, quadrilateral and still more complex patterns of trade become possible. This is the system which prevailed before 1914, and again in the twenties. Multilateral trade, because it allows everybody to buy where he can buy cheapest, guarantees the maximum gains from international trade.

I

At present almost every European country has a bilateral agreement with every other European country (and also with a large number of non-European countries). There are several types of bilateral agreements; some do not allow for any multilateral trade, others do allow for some; and there are still others which, though in and by themselves are strictly bilateral, have been supplemented by agreements, or by administrative practices, which allow a certain measure of multilateral trade.

Under the first type of agreement, commercial transactions between the two countries, for example, between Italy and Holland, or between Italy and Sweden, take the form of barter. Here every export carries with it a corresponding import, so that the trade between the two countries is automatically balanced. Multilateral trade is not possible under this type of agreement. A country is likely to resort to this type if it fears that otherwise it will have a large and persistent export surplus toward the other country and will continuously accumulate inconvertible balances in the latter.

Under the second type of agreement, the countries grant each other credit margins with the proviso that if one of them exhausts it, it must pay for any further import surplus from the other in gold. Such agreements exist for instance between Great Britain and Belgium, and between Great Britain and Switzerland. In the last few years Great Britain, or more accurately the sterling area, incurred a deficit toward Belgium and Switzerland and, as soon as the deficit exceeded the credit margin, had to pay for further imports in gold. This meant, of course, that for Belgium and Switzerland sterling became convertible into gold from a certain point on; these two countries could use the gold they required to purchase wherever they wished, that is, they could engage in multilateral trade. Since, however, Great Britain was careful to limit imports from these two countries in order to minimize the loss of reserves, the " gold clause " in these agreements had the effect of cutting down the volume of foreign trade rather than of promoting multilateral trade.

The third type of clearing agreement is of the same general type as that just mentioned but without a " gold clause ". Here the balances accumulated by the creditor country cannot be converted into gold no matter how large the balances are. Agreements of this kind thus lead to strict bilateralism, unless they are supplemented by other agreements or administrative practices to which I shall return presently. Strict bilateralism does not, of course, mean that exports and imports will necessarily balance; it means that a country which has an export surplus to another country accumulates inconvertible balances in the latter. However, whenever such agreements (and the

same applies to agreements containing a gold clause) come up for renewal, the creditor country is usually reluctant to extend further credit, so that a long-run tendency exists toward the bilateral *balancing* of trade. It was in order to avoid this development that provision was made in the Intra-European Payments and Compensations Scheme for the potential creditor countries to grant "drawing rights" to the potential debtor countries, with the condition that the creditor countries should obtain Marshall dollars to the extent to which drawing rights granted by them were utilized. This was a way of inducing the potential creditor countries to continue granting credit to potential debtor countries.

Two developments have, however, made a limited degree of multilateralism possible even under this system of bilateral agreements; they are the creation of the so-called "Transferable Account Group" by the British Treasury, and the Intra-European Payments and Compensations Scheme worked out by the O.E.E.C.

a) Great Britain instituted in 1947, in preparation for the establishment of convertibility of the pound sterling, the Transferable Account Group which, on a reduced scope, survived the convertibility crisis. The members of this group (at present Holland, Norway, Sweden, Denmark, Italy and a few other countries) are allowed to use their sterling balances to pay for imports from any other member of the group as well as for imports from Great Britain and the sterling area. Thus Sweden may use her sterling balances to pay for purchases in Holland. The condition for the inclusion of a country in this group is that the country should either have an over-all equilibrium in its balance of payments with the rest of the group, or have a surplus which does not exceed the amount of sterling balances the country is willing to hold. To the extent to which sterling balances are used for payments within the group, trade proceeds on a multilateral basis. Even for countries that are not in the Transferable Account Group, the British Treasury can and does occasionally permit the transfer of sterling balances to third countries. One should, however, not exaggerate the degree of multilateralism made possible by this arrangement. Italy for instance is a member of the group but found it impossible, at

least before the devaluation of sterling, to use her sterling balances for purchases in third countries, because the lira was undervalued in terms of the currencies of members of the group, a situation which, if the cross rates were to be kept in line, could not be remedied without a change in the lira-dollar rate. The lira-dollar rate was, however, a " realistic " rate and needed no adjustment.

b) The second development is the Intra-European Payments and Compensations Scheme. This scheme is very complicated indeed, and a detailed analysis of it is far beyond the scope of this paper. The scheme provides for two types of compensation: first category and second category compensations. The first category compensations, which are obligatory, lead to an all-round reduction of foreign balances held by the countries involved in the compensation. Thus Great Britain may have accumulated balances in France, France in Denmark, and Denmark in Great Britain. The accumulated balances are at the end of each month offset against one another to the maximum possible degree. The balances that remain are then cancelled against an equal amount of drawing rights (where such drawing rights exist). The result is that these drawing rights are less quickly exhausted than would be the case if the first category compensations had not been undertaken. The compensations thus increase the volume of intra-European trade; but they do not change its bilateral character, as, for example, the once proposed scheme for making drawing rights convertible (that is, for allowing the drawing rights to be used for making purchases anywhere in Europe) would have done.

The second category compensations are in principle not different from the " compensations " that take place within the Transferable Account Group. Their essence consists in making payment for deliveries of commodities between two countries in currencies of third countries. They require the consent of the participants, and as such consent has seldom been forthcoming, they have not yet amounted to much in practice.

In the second year of the scheme further progress has been made toward multilateralism, inasmuch as 25 per cent of the drawing rights have been made transferable, that is, they may be used for making purchases anywhere in the O.E.E.C. countries.

II

In spite of this progress, we are still very far from a system of full multilateral trade. I may remind you that such a system means two things: (1) that a European importer should be able to purchase commodities wherever he likes, which implies that export proceeds, no matter in what currency they are acquired, can be converted into any other currency; and (2) that loans made by one country to another should have no strings attached to them, that is, the debtor should have the right to use the proceeds from the loans to make purchases not only in the lending country but anywhere in the world. Why is it not possible to return to such a system, or, to put the question differently, what are the conditions under which a return would be possible?

Those in charge of commercial and foreign exchange policy in European countries, if they were asked why in their opinion a return to full multilateral trade cannot be achieved in the Europe of today, would probably give as the main reason the "dollar shortage" from which most European countries suffer. In connection with the argument that this so-called dollar shortage is the main obstacle to multilateral trade, I should like to emphasize two points very strongly.

1) We must distinguish between a single European country and Europe as a whole; and I contend that, although the dollar shortage may seem a good reason for any individual country to favor bilateral agreements and inconvertibility of its currency, Europe as a whole does not save dollars by such methods.

Take as an example the bilateral agreement between Belgium and Great Britain. Great Britain by accumulating debts toward Belgium, in the form of inconvertible sterling balances, obviously saves the dollars, which she would have had to surrender to Belgium if those balances had been convertible into dollars. But Belgium's dollar shortage is increased by the same amount, inasmuch as she cannot obtain dollars in exchange for her sterling balances. To finance her deficit toward America she has to draw down her dollar reserves to a larger extent than would be the case if sterling were convertible. Both countries taken together do not save dollars or gold by reason of bilateral agreements and the inconvertibility of their currencies into dollars. Indeed, bilateral agreements take on the character of a

struggle by each country to overcome, or relieve, its own dollar shortage by increasing (or even creating) the shortage for other countries. For Europe as a whole bilateral agreements and inconvertibility of currencies have contributed nothing to the overcoming of Europe's dollar shortage. On the other hand, it is understandable that an individual country which fears an over-all deficit in its balance with the rest of Europe should insist on inconvertibility of its own currency as a safeguard against further losses of gold and dollars. But my argument also shows that once each European country has achieved a rough equilibrium in its balance of payments with the rest of Europe, so that none accumulated balances in other European countries beyond what it was willing to hold there, European currencies could be made at least transferable into each other (though not into dollars); and this would be a great step forward in the direction of multilateral trade.

2) The second point is this: a "dollar shortage" is now generally taken to mean that a country suffering from it draws on American resources in order to raise its investments or its consumption above the level that would be possible if it were to rely exclusively on its own resources. Now it is clear that as long as the European countries obtain aid from America they necessarily (by definition) live beyond their means. There is nothing alarming in this situation, nor is the dollar aid an excuse for bilateralism and inconvertibility of currencies. Many countries have for years borrowed from abroad, and have lived beyond their means before, under a system of truly multilateral trade and fully convertible currencies. The situation becomes alarming only (1) if the European countries, for example, Great Britain, lose gold and dollar reserves even though they are receiving aid from the United States; and (2) if they cannot hope that their economies will be "self-supporting" by 1952 when Marshall aid comes to an end, so that, even if they are not losing dollar reserves at present, they must expect a dollar drain to set in once aid comes to an end, and fear that, once their dollar reserves are exhausted, unemployment and a general decline in the standard of living will result.

In order to reëstablish multilateral trade, and full convertibility of their currencies, by 1952, those European countries which suffer from a dollar drain must stop this drain, and all of

them must prepare for the day when Marshall aid comes to an end by accumulating dollar reserves. This requires for many of them the cutting down of their domestic investments and/or of consumption below the level that now obtains.

The British case is a good illustration of this point. Devaluation of the pound sterling is not sufficient to reach this goal. It will doubtless bring at least temporary relief; but if the relief is to be more than temporary, the devaluation must be combined with measures which aim at internal financial equilibrium in the sense that investments are covered by current savings (public as well as private). Such internal financial equilibrium requires in Great Britain cutting the budget, cutting investments (public and/or private), preventing general wage increases, and getting rid of rigidities in the productive system. It should also be clear that a country in the position of Great Britain can ill afford to export capital to other countries, or to repay external debt by reducing her sterling balances; for capital export, or the reduction of external debt, means that if equilibrium between current investments and savings is to be maintained in Great Britain, home investments must be reduced still further, or else that domestic consumption must be decreased in order to augment current savings by an amount equal to the capital export or debt reduction.

III

The fact that the dollar shortage is the main obstacle to the reëstablishment of multilateral trade in Europe does not justify the conclusion that no progress can be made toward this goal of multilateralism until *every single* European country has brought its balance of payments into equilibrium with the dollar area. Two courses of action are open at present.

1) Not all European countries are short of dollars; and those which can be said to be short are so in different degrees. Switzerland, for instance, has too many dollars and too much gold, and has even made strenuous efforts, at least up to the devaluation of the pound sterling, to avoid the acquisition of dollars. Belgium and Italy are creditor nations toward the rest of Europe, and if they can be said to suffer from a dollar shortage at all (which is doubtful), it is safe to say that they would not do so if the balances which they currently accumulate in

Great Britain and elsewhere were convertible into dollars. Here is then a nucleus of countries for which general convertibility of their currencies (and therefore multilateral trade) could be introduced, with some help from America. It would be possible for these countries to follow, with respect to the rest of Europe, the same policy which the United States pursues; that is, they could refuse to enter into any bilateral agreements, and each of the " nucleus " countries could insist that other European countries should pay for imports from that country in the latter's own currency or in any other currency that is convertible (for example, Great Britain would have to pay for her imports from Belgium either in Belgian francs or in lire or in Swiss francs or in dollars or gold). Such a policy would require four things:

a) The countries willing to move in this direction should receive additional dollar reserves as part of the Marshall aid; that is, they should be allowed to use part of the aid to add to their foreign exchange reserves in order to create a sufficient *fonds de manoeuvre.*

b) A sufficiently important number of countries should simultaneously start on this course of action.

A single country, such as Italy, considering whether it should make its currency convertible, may fear that other countries will make every effort to increase exports to, and decrease imports from, Italy in order to obtain convertible currency with which to buy in third countries, especially in the United States, thus causing a drain on Italy's dollar reserves. Such a drain if it develops at all would not, however, set in immediately, but only after Italy's balances in these countries have first been reduced to the level of the minimum necessary working balances. Nevertheless, the fear of such a drain is real. It can, however, be shown that the greater the number of countries introducing convertibility, the smaller is the chance of such a drain. And for this reason it is better if several countries embark simultaneously on such a policy.

c) A flexible exchange rate policy must be followed. The countries can use their dollar reserves as a stabilization fund, but in case a drain on their reserves develops, they must be able to change the external value of their currencies until a realistic rate with respect to the dollar is found.

d) The group of countries renouncing bilateral argreements must be willing to undergo adjustments of their economies. The unwillingness to do this is, next to the dollar shortage, the strongest force causing countries to cling to bilateral agreements. A good example is Switzerland. Switzerland has no shortage of dollars, and yet she adheres to a system of bilateral trade agreements, chiefly because she aims at preserving a certain structure of her exports by making the partner countries to these agreements import watches and other Swiss export goods and allow their citizens to travel in Switzerland. She has even gone so far as to make balances of Swiss francs accumulated by Argentina and the Bizone of Germany inconvertible into dollars, so as to force these countries to use the balances for purchases or travel in Switzerland. Indeed, this unwillingness to make adjustments in the economy will make it difficult (as the Swiss example shows) to get rid of bilateralism even at a time when the dollar shortage has been overcome.

If, with the support of the United States, some of the creditor countries in Europe could be induced to follow the policy I have outlined, it would undoubtedly accelerate the reëstablishment of *general* convertibility of currencies and therefore of multilateral trade, because, by making it impossible for them to rely on being able to go on borrowing indefinitely from the nucleus countries, it would increase the pressure on the countries remaining outside the nucleus to bring their balance of payments into order.

2) The second course of action would aim at something less than full convertibility of European currencies. It would aim at what is now called " transferability " of European currencies, that is, convertibility of European currencies into each other, but not into gold or dollars. Italy, France and Belgium have started negotiations with a view to making their currencies transferable in this sense. I have pointed out before that such transferability can be introduced within a group of countries, provided each country in the group has a rough equilibrium in its balance of payments with the rest of the group or has a surplus not exceeding the amount of balances it is willing to hold. The willingness of a country to hold balances to any considerable extent in the rest of the group can be expected only if the exchange rates between the members of the group remain

roughly stable so that a country having such balances need not fear any decline in their value in terms of its domestic currency. The creation of a group of transferable currencies on the continent would be equivalent to the creation of a continental "Transferable Account Group", which might perhaps later be joined with the British Transferable Account Group.

My guess is that the second course of action will be taken. Without minimizing the great progress toward the goal of multilateralism, which such a policy would initiate, I should prefer to see countries which are in a position to do so establish (with American help) full convertibility. This course would put pressure on other countries, and would set an example which shows that "it can be done"; further it would have the advantage of simultaneously introducing intra-European transferability and convertibility of European currencies into dollars, whereas the mere introduction of transferability between some European countries leaves the dollar problem still unsolved. But I would emphasize again that such a policy can be followed only if it is accompanied by a flexible exchange rate policy (and this unfortunately is against the principles of the Monetary Fund) and if the European countries are willing to undergo the necessary internal adjustments in their economies.

REMARKS BY THE CHAIRMAN

CHAIRMAN WOLMAN: Thank you, Professor Lutz.

We now return to Columbia University for a discussion of another fundamental factor in the recovery of Europe, economic organization. Our next speaker has for many years been a student of European economic history. It gives me great pleasure to introduce Shepard B. Clough, Professor of History at Columbia.

TOWARD EUROPEAN ECONOMIC ORGANIZATION

SHEPARD B. CLOUGH
Professor of History, Columbia University

THAT anyone should stand up on this day of grace, in a public meeting of such well-informed and seriously minded persons as attend the sessions of the Academy of Political Science, to present a paper entitled " Toward European Economic Organization " is direct evidence that that person is either daffy, ignorant, or enormously optimistic. Being generous and charitable people, you will, I hope, delay the choice of adjective by which you want to characterize me until I have had a chance to state my case. That there may not be too much hesitation in your minds, however, let me say immediately that, although there is some movement toward European economic organization and coöperation, I consider that movement about the size of a molehill compared with the mountain of European economic nationalism, economic disorganization, and economic dislocation. I propose to discuss the molehill, but in no wise do I intend to make a mountain out of the little pile. I propose further to concentrate my attention upon the Organization for European Economic Co-operation which is the mole, or at least the father mole, that is making the hill about which I speak.

Before I proceed with a consideration of the O.E.E.C., I deem it desirable to address myself briefly to the question: why is there a problem regarding European economic coöperation? As the chairman has stated, I am a professional economic historian and in the tradition of my profession I am impelled to provide an historical setting for my analysis—to give you what, in the trade, we call background.

In short, the background is this. Western European states achieved their position of economic and political primacy in the world of the nineteenth century by becoming the workshop of that world. They received raw materials and foodstuffs from non-Western European sources and with their superior technology transformed the raw materials they received into goods the rest of the world wanted, and the foodstuffs into men to

run their machines. As an integral and necessary part of this process, a system of multilateral trade and payments developed and flourished. Then gradually toward the end of the nineteenth century and more speedily with World War I, the deep depression of the 1930's, and World War II, dependence of the world on Western Europe for industrial goods was reduced and the intricate network of world multilateral trade was distorted and practically destroyed.

Other parts of the world built their own workshops; the World Wars and the depression hastened Europe's loss of markets to newly industrialized areas; and the exigencies of war resulted in the liquidation of most of Western Europe's overseas investments which had helped to pay for her imports. Long-term trends were brought speedily to a climax. How was Western Europe to live in the manner to which it had become accustomed?

Western Europe's plight was not a professional secret of the historians or economists. Everyone knew about it. Perhaps historians were, however, the most pessimistic regarding it. They not only presented the analysis which I have just given you, along with estimates of the physical destruction wrought and the cost of reconstruction, but they also stressed the fact that Western Europe was divided into sovereign nationalist states which seemed bent on destroying themselves by war. Historians compared Western Europe with Ancient Greece, where city-states, never having succeeded in effecting political unity, fought each other to exhaustion and thus became the victims of invaders from inferior cultures. The analogy seemed, indeed, to be uncomfortably pat.

The United States has been loathe to see Western Europe succumb to internecine strife or to become the victim of " barbarian " invasions. Since World War I our policy in this regard has been consistent. Not only has this country intervened in Europe's wars, but it has financed an excess of exports over imports from which Europe has been the chief beneficiary. From 1914 to 1949 this excess amounted to $101,000,000,000, which was made possible by American gifts, gold purchases, the buying of foreign holdings in the United States, and loans, most of which have been defaulted.[1] From July 1, 1945 to December

[1] *Report of the E. C. A.—Commerce Mission*, October 1949, p. 2.

31, 1947, the United States authorized aid to Europe to a sum somewhat over $11,000,000,000 [2] and under the Marshall Plan authorizations for expenditures reached $7,000,000,000 by October 1949. Throughout all the annals of history one cannot find a comparable amount of assistance given by one country to foreign lands.

In spite of the aid which the United States provided Europe immediately after World War II, Western Europe's demand for American goods and services remained high, while Europe's ability to pay for the things it needed lagged far behind. The resulting " dollar shortage " in Europe reached a climax in the spring of 1947. At the crucial moment General George C. Marshall delivered his now famous speech at Harvard University, June 5, 1947.

> Europe's requirements for the next three or four years of foreign food and other essential products—principally from America—are so much greater than her present ability to pay that she must have additional help or face economic, social, and political deterioration of a very grave character . . . .
>
> Before, however, the United States can proceed much further in its efforts to alleviate the situation and help start the European world on its way to recovery, there must be some agreement among the countries of Europe as to requirements of the situation and the part these countries themselves will take in order to give proper effect to whatever action might be taken by this government.

Here was the prospect of further American aid, but on the condition of economic collaboration and coöperation among European nations. From this prospect has stemmed most of the molehill movement toward European economic coöperation. Prior to June 5, 1947 such a movement was completely nonexistent. This point can hardly be made too strongly. The European movement toward economic coöperation was at the beginning and continues to be very largely American made.

Following General Marshall's speech, the Western European nations acted with breath-taking speed. On July 3, 1947, Mr. Bevin, the British Foreign Secretary, and M. Bidault, the French Foreign Minister, issued invitations to all European countries

[2] *United States Senate Report No. 935, European Recovery Program. Report of the Committee on Foreign Relations* (Washington, 1948), p. 9.

except Spain, which was not wanted, and the U.S.S.R., which had refused to participate, to a conference in Paris for drafting a report that would be presented to Secretary Marshall in response to his Harvard declaration. To this conference came representatives of the United Kingdom, France, Austria, Belgium, Denmark, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Sweden, Switzerland, and Turkey—the sixteen states which ultimately agreed to join in a movement of economic collaboration and with which became associated the Bizone and French Zone in Germany (more recently the West German Federal Republic) and the Free Territory of Trieste.

The proposed conference began its discussions on July 12 and within four days created a Committee of Economic Co-operation charged with the task of preparing the actual report. This Committee terminated its work by September and on the twenty-second of that month dispatched its findings to Washington.[3]

Then on March 15, 1948 representatives of the countries already named drafted a Convention for European Economic Co-operation which was signed on April 16, 1948 and subsequently ratified. It was this Convention which brought the Organization for European Economic Co-operation into being, specified the main lines of its structure, and stated the principles that should guide its activity. These principles are as follows:

(1) That a strong and prosperous European economy is essential for the attainment of the purposes of the United Nations, the preservation of individual liberty and the increase of general well being;

(2) That European economic systems are interrelated and that the prosperity of each of them depends on the prosperity of all;

(3) That only by close and lasting coöperation among the Contracting Parties can the prosperity of Europe be restored and maintained, and the ravages of war made good;

[3] *Committee of European Economic Co-operation, July-September, 1947* (London, 1947), 2 vols. The proceedings of the prior Conference with the U. S. S. R. are recorded in the French Yellow Book, *Conférence des Ministres des Affaires Etrangères de la France, du Royaume Uni, de l'U.R.S.S., du 27 juin au 3 juillet, 1947* (Paris, 1947).

(4) That there must be the establishment of sound economic conditions as soon as possible to achieve and maintain a satisfactory level of economic activity without extraordinary outside assistance, and to make their full contribution to world economic stability;

(5) That the Contracting Parties shall combine their economic strength to this end, and shall join together to make the fullest collective use of their individual capacities and potentialities, to increase their production, to develop and modernize their industrial and agricultural equipment, to expand their commerce, to reduce progressively barriers to trade among themselves, to promote full employment, and to restore or maintain the stability of their economies and general confidence in their national currencies;

(6) That conditions and institutions necessary for the success of European economic coöperation and for the effectiveness of American aid shall be created and established.

To the captious these high-sounding aims were rather preposterous in a world ridden with economic nationalism. Yet, that they could be expressed at all in an international convention was a recognition of the need for change, even though the impetus for the action came with the bait of American assistance.

Upon the shoulders of the Organization for European Economic Co-operation was placed the burden of giving effect to the principles laid down. This organization, like so many international bodies, is primarily a jousting place for national interests. Its decision-making organ is the Council, composed of official representatives, usually foreign or finance ministers, from all participating countries. These men are not international civil servants; they are responsible agents of sovereign states whose traditional duty it is to favor the interests of their nations in the highest possible degree. Some steps have been taken, however, to mitigate the national position of these men. They have to arrive at their decisions by unanimous vote; the Council's Executive Committee of only seven members, designated annually, necessitates the consideration of issues from an international rather than from a national point of view; and a technical staff of really international civil servants means the

elimination to a large extent of national considerations from data available to the Council.[4]

The O.E.E.C., which came into being in April 1948, has been primarily concerned with three issues: (1) the allocation of American aid among the participating countries; (2) the reconstitution of intra-European trade; and (3) the development of Western Europe as an integrated economic unit. Its handling of each of these problems gives understanding of the movement toward European economic coöperation.

First let us consider the problem of dividing American aid. For the third quarter of the calendar year 1948, representatives of the United States informed O.E.E.C. that it must prepare a program of allocations covering the requirements of all participating countries taken together and that this program should be within the dollar amounts available. Obviously the United States wanted to avoid getting in the position of having to partition aid to each country and of being the target of those who felt that they had been unfairly treated.

To establish a yardstick whereby American aid could be divided, O.E.E.C. has had to collect information about the participants' economies and about their future plans for development, especially those which would result in dollar earnings or dollar savings. What has distinguished this information from that provided by other sources is that it reveals either the plans or estimates of responsible governments for the future. It has furnished some idea of the objectives which are hoped to be reached by July 1, 1952, when American aid is expected to cease.

Although various considerations go into the final decision regarding allocations of aid, the principal yardstick for granting

[4] The technical staff is organized into two major types of committees, horizontal and vertical. The horizontal committees are responsible for the study of specified economic problems covering all member countries; the vertical committees, for studying a more specific branch of economic activity. The horizontal committees are: (1) Programs, (2) Balance of Payments, (3) Trade, (4) Inter-European Payments, and (5) Manpower. The vertical committees are: (1) Food and Agriculture, (2) Agricultural Machinery, (3) Coal, (4) Electricity, (5) Oil, (6) Iron and Steel, (7) Raw Materials, (8) Machinery, (9) Non-Ferrous Metals, (10) Chemical Products, (11) Timber, (12) Pulp and Paper, (13) Textiles, (14) Inland Transport, and (15) Maritime Transport.

assistance is a state's deficit in trade and payments. Some balance in trade and payments is necessary in judging the viability of an economy, but placing so much weight upon it has led to criticism and even bitterness. For example, a state that brings its trade and payments into balance by enormous sacrifices and otherwise achieves the goals of the Marshall Plan will presumably get less aid than the state which does not make these sacrifices. Furthermore, in the allocation of aid account is not taken of the fact that income per capita in some countries is greatly inferior to what it is in others. Concocting adequate incentive payments in an aid-giving plan is obviously a difficult proposition, albeit a necessary one. Undoubtedly at the back of the statement by Paul Hoffman, Administrator of the Economic Co-operation Administration, that allocations for the fiscal year 1949-1950 will be given during the first half on the basis of decisions reached by O.E.E.C., is the hope that allocations may be changed in the second half-year to reward those states which have made progress toward Marshall Plan objectives.

The attention which O.E.E.C. has had to give to the allocation of American aid accounts in large measure for the fact that the participating nations are frequently regarded as hungry and squabbling children struggling to get the biggest piece of the American pie. Although this appraisal is not entirely unjustified, O.E.E.C. has had some success in getting nations to see others' problems and in convincing them of the wisdom of concessions. Such coöperation has been absolutely essential, for it is a condition of getting any aid at all.

In addition to dividing aid, O.E.E.C. has endeavored to resurrect intra-European trade.[5] When the Marshall Plan came into being, everyone lamented the fact that intra-European trade was hampered by bilateral agreements which tended to force each pair of countries to reach an exact balance. As O.E.E.C. studied programs for the third quarter of 1948, it realized that some products shown in dollar import demands of certain countries were available in member countries. Immediately the question was raised of substituting these surplus commodities in member countries for imports from the United States. At first special allocations of American aid were given

[5] Efforts in this direction were envisaged by the Committee of European Economic Co-operation in its *General Report*, vol. I, p. 83.

to permit debtor countries to pay for purchases which had to be met in dollars from countries other than the United States to make so-called "off shore" purchases. In October 1948 there was substituted for this arrangement the Intra-European Payments and Compensations Agreement. This system provided for a multilateral clearing of trade balances and for making part of American aid to creditor countries contingent upon the amount of credit (drawing rights) they would extend to other countries.[6]

Under this scheme intra-European trade is being restored. That trade which had fallen in 1946 to about one-half its 1938 volume recovered to about ninety per cent of its pre-war scale in 1948. Yet, drawing rights based on dollar aid accounted for four fifths of European clearances from October 1, 1948 to March 1, 1949 and compensations for only one fifth of them. Moreover, mention should be made of the fact that the composite programs of member countries do not envisage an increase by July 1, 1952 in intra-European trade above 1938, in spite of a probable nine per cent increase in population. This seems inconsistent with the avowed objective of developing a high level of trade.

Furthermore, intra-European trade is still hampered by exchange controls (the inability to exchange freely one currency for another), by quantitative restrictions on imports (import quotas), by double pricing (the charging of higher prices on basic commodities sold abroad than are charged at home), and by tariff walls, some of which are prohibitive. How difficult it

[6] "Creditor countries agreed that the allotment of that part of their dollar aid which was equivalent to their estimated surplus in Europe should be contingent upon their contributing a like amount in their national currencies from the sums set aside as a counterpart to that dollar aid. The debtor countries could then be granted drawing rights against the creditor countries for the amounts of their deficits in the appropriate currencies; they could exercise their rights under a scheme of compensations to be administered by the Bank of International Settlements, as agent for O.E.E.C. and they could cover their deficits with the creditors month by month.... The operation of the Agreement is not restricted to the metropolitan territories of the participating countries, but extends to the monetary areas associated with them, a substantial portion of the world of international trade." *Interim Report of the European Recovery Program*, O.E.E.C., Dec. 30, 1948.

will be to get rid of these impediments to commerce or, for that matter, to achieve a greater degree of European economic integration can be judged from events at the recent meeting of the O.E.E.C. Council. At this session Mr. Hoffman made a strong plea for haste in moving toward greater European economic coöperation and supported his request with reference to the favorable impression such action would have on Congress and American public opinion. The immediate response to this thinly veiled warning was a resolution by the Council that member nations should free one half of their mutual commerce from quota controls by December 15, 1949 or, if that were not possible, to report their reasons for not doing so to the Council.[7] In addition it decided that countries which were creditors in intra-European trade must not count henceforth on payments in dollars or gold, which was a small step toward establishing the transferability of currencies. Obviously the freeing of intra-European trade will remain on the agenda of the O.E.E.C. for some time to come.

While the division of American aid and the reconstitution of intra-European trade have been the main concerns of O.E.E.C., the Organization does have in view the development of Western Europe toward an integrated economic unit and has taken some minor steps in that direction. As has already been stated, it has found surpluses in Western Europe which have been moved into trade in order to reduce purchases from the United States. It has discovered unused productive capacity and has been instrumental in putting that capacity to work for other states.[8] It has coöperated with the United Nations Economic Commission for Europe in the allocation of coal supplies. It has furthered the effective use of manpower by seeking bilateral agreements for migration of surplus workers to areas where they could find productive employment. It has proposed the standardization of products and the staggering of equipment pur-

[7] Sessions of the Council, October 31 and November 2, 1949.

[8] For example, a surplus petroleum refinery plant in France has been placed at the disposal of the United Kingdom; the Bizone and French Zone in Germany have obtained surplus freight cars from Italy and Belgium; and France and Switzerland have made arrangments to exchange electrical current.

chases, especially in the railroad industry. And it has fostered the establishment of customs unions within Western Europe.[9]

At present one of O.E.E.C.'s most ambitious studies pertains to investments regarding ferrous metals, fertilizers, petroleum refining, and electrical production. The goal is to prevent unnecessary duplication of plant among participating countries and to encourage the production of goods in those places which have the greatest comparative advantages. Here is a direct attack upon the concept of national autarky, but one wonders to what extent the plan will move from the drafting board to the hard world of actuality. To date action of the kind envisaged has been taken primarily by E. C. A. in its approval of projects.

Difficulties in the way of this and other measures of economic coöperation must not be underestimated. Economic activity in Western Europe is very largely in the hands of private enterprise, and governments, even after they have signed agreements, cannot always exercise enough control to see that their commitments are made good. To a considerable degree, the influence of O.E.E.C. in the matter of investments may be simply in the establishment of data for the guidance of private enterprise.

How much economic coöperation there will be in Western Europe when American aid ceases is a serious question and one that invites speculation regarding the continuance of that aid. The fact that indices of production show that most participating countries are turning out goods at better than pre-World War II rates raises a doubt about the necessity of further assistance. The doubt is partially allayed when one realizes that Western European population is growing at an unexpected pace and that

[9] The broad plans for the Economic Union of Belgium, Luxembourg, and the Netherlands antedate the creation of O.E.E.C., for they stem from September 1944. The Customs Union Agreement was signed on January 1, 1948 and was scheduled, before British devaluation, to go into effect January 1, 1950. In a protocol signed in Turin March 20, 1948, France and Italy have announced their intention of forming a customs union. A joint committee of the governments of Denmark, Iceland, Sweden and Norway was established in the summer of 1947 to study economic coöperation and the creation of a customs union about these northern countries. On November 3, 1949 these nations stated that they would take prompt action toward forming a customs union.

many of the goods produced are used for repairing the damages of war and not for raising Western Europe's pre-war material welfare. Doubts about the continuation of American aid arise also from an avowed policy of restricting American sales to Europe and from efforts being made to increase European imports into the United States in order to relieve the dollar shortage. Perplexity regarding our aid may also come from such statements as the following from the Chairman of the Council of O.E.E.C.:

> If it was at one time our belief that European recovery was proceeding fast enough to make it possible to achieve viability in 1952, we must now admit that the rate of progress is not sufficient. The dollar problem, despite the improvement in the situation over the last two years, is not on the way to solution.[10]

Pitted against scepticism arising from such sources regarding the advisability of continuing aid will be America's desires for a strong and friendly Western Europe. I reiterate that since 1917 the United States has pursued a policy aimed at preventing Western Europe from becoming the prey of invaders or from adopting a position hostile to us.

When American aid does come to an end, the slow movement toward European economic coöperation will be put to the real test. No one in his right mind should expect a sudden conversion of Western Europe from economic nationalism to internationalism. Nor should anyone be under the illusion that a piece of machinery like O.E.E.C. will provide the dazzling light which will turn men toward new patterns of behavior. European nations will continue to regard their sovereign rights to unilateral economic action as inviolable, and unilateral action can easily destroy our little molehill. The recent British devaluation of the pound sterling is a case in point—a blow which crippled our little mole. There will continue to be rivalries among nations which will make economic integration difficult. There will be the fear that a renascent Germany may dominate any Western European economic organization, and there is always the possibility that certain nations will form economic

[10] Report of the Chairman of the Council and the Secretary General in the Division of American Aid and on Drawing Rights for 1949-50. August 31, 1949.

blocs which will pursue policies hostile to other Western European nations or blocs of nations.

At the most all that can reasonably be expected is that the molehill will keep on growing. To this end O.E.E.C. will make some contribution. At least the organization is training a corps of international civil servants in thinking about Western European problems as such and of forming policies beneficial to the whole area. Moreover, the idea that Western Europe must cooperate or face possible disaster is growing. Perhaps no better evidence of the increasing strength of this idea can be found than in the declaration of Paul Reynaud at the Consultative Assembly of the Council of Europe at Strasbourg:

> Everyone agrees that between the two giants we must have a Europe, but it must not be a fragmented Europe . . . . We must realize how great is the need in every one of our countries for a European market with a single currency . . . . Europe's position is tragic . . . . Europe has been living from hand to mouth, first by means of loans, then grants and now by means of Marshall aid. If the cake should become smaller next year, or if Marshall aid should end before June 30, 1952, and we have not reached agreement, then, due to lack of dollars we shall not be able to obtain certain raw materials. This will mean that some of our factories will cease working and that workers will become unemployed. This would result in a victory for Stalin.[11]

[11] M. Paul Reynaud at the Consultative Assembly of the Council of Europe, Strasbourg, France, August 23, 1949. *The New York Times*, August 24, 1949, p. 6.

Remarks by the Chairman

Chairman Wolman: Thank you, Professor Clough.

I am sorry that we have reached the time of adjournment, and I know you will join with me in thanking our three speakers for this enlightening and comprehensive discussion of the European economic recovery problem. I thank you all for coming, and I hope many of you will return for the afternoon session.

PART II

THE FOREIGN AID PROGRAM AND AMERICAN FOREIGN POLICY

INTRODUCTION *

PERCY W. BIDWELL, *Presiding*
Director of Studies, Council on Foreign Relations

I HAVE the great pleasure of opening the afternoon session of this meeting of the Academy. Our topic is "The Foreign Aid Program and American Foreign Policy". As our first speaker we have Professor Seymour Harris, Professor of Economics at Harvard University. Professor Harris has done, I think, great service to the community in giving us a better understanding of both domestic and foreign economic problems. He is editor-in-chief of one of the most distinguished publications in the field of economics, *The Review of Economics and Statistics*. We are indebted to him for a standard book on exchange depreciation which he published in 1936. Since that time, he has excited the envy of all of his colleagues in the academic field by the publication of a series of extremely interesting and useful books of his own authorship and a number of collections of symposia to which outstanding authorities in the field have contributed. Recently, he has taken over a series of radio discussions which have added a great deal to the public understanding of current economic problems.

It gives me great pleasure to introduce Professor Harris whose topic will be "Foreign Aid and the Domestic Economy".

* Opening remarks at the Second Session of the Annual Meeting.

FOREIGN AID AND THE DOMESTIC ECONOMY

SEYMOUR E. HARRIS
Professor of Economics, Harvard University

I. *The Issues*

1. *Who Is to Bear the Brunt of the Adjustments?*

The choice that lies before this country is between putting the burden of the large adjustments in international economic relations upon the taxpayer (continued foreign aid by government), or upon private investors (with some support by government), or upon American manufacturers and merchants (through losses of sales in this market and especially abroad).

2. *The Magnitude of the Adjustments*

We compare 1947 and, say, 1952. From an excess of $10 billion of exports to an excess of $2 billion of imports in 1952 is a measure of the adjustment required. This means that industry will have to make these large adjustments telescoped within relatively few years. (The government is protecting the market of farmers.) These $12 billion may be put against about $60 billion of income originating in manufacturing or against $200 billion of sales of manufactured goods. The average loss of sales would be 6 per cent; and in many industries the proportion would be much higher. A loss of sales of this magnitude would bankrupt many firms and even industries.

3. *Leavening Factors*

A rise in total sales at home would facilitate the adjustments, as would continued growth abroad. Continued prosperity in 1948 reduced the strain associated with a decline of $5-6 billion in the excess of exports in that year. A problem of adjustment which might be insoluble under depressed conditions might become soluble under continued prosperity. Again, in so far as agriculture will bear part of the burden, the strain on industry would be reduced. Actually, agricultural exports would decline; this might be offset by increased pressure to cut agricultural imports.

4. *Directed Allocation of Factors of Production*

At the very least, the government should help industry and labor make the required adjustments: movement of labor and capital into domestic industries and discouragement of flow of labor and capital into export and import competing industries.

5. *The Case for a Long-Term Aid or (and) Loan Program*

It would be easier to make the required adjustments of $14 billion in trade over 20 to 50 years than $12 billion over 5 years. (The more that is advanced, the larger the rise of imports required to cover financing charges.) The more concentrated adjustment over 5 years puts the responsibility upon a limited segment of American economic life—export industries and those competing for imports. Unfortunately, the long-range program is likely to mean additional burdens on the taxpayer; and so long as government spending remains at high levels, the additional pressure on government for foreign aid is not likely to yield increased demand and output. In fact, one of the peculiarities of our foreign aid program over the last 35 years is that it has not greatly contributed to an increased output; for the major gifts and loans were made in inflationary periods. Should depression develop in the fifties and sixties, then any rise in output associated with increased foreign aid and loans would be offset.

6. *The Required Adjustments Are Not Likely to Be Made by 1952 Without Further Aid or Loans*

Surely past experience does not suggest an early equilibration. Note the long period of dollar shortage, the rise of Europe's exports to the United States of but $100 million in 1948 (in 1947 dollars) against a rise of national income for Europe (exclusive of U.S.S.R.) of $9 billion, or roughly but 1 per cent; or the rise of United States imports of 5 per cent against a rise in real terms of income of 67 per cent since 1938; or the required rise of United States imports from Europe of 400 per cent (with a reduction in dollar prices of 20 per cent) to balance Europe's accounts; or, should the balancing occur largely in other overseas countries, the terrific pressure here to devalue as our exporters lose markets.

7. *Dollar Shortage the Perennial Problem*

Of more than $100 billion excess of exports since 1914, this country has given away at least four fifths. (I include as part of the philanthropy a net inflow of gold of more than $20 billion.) Despite the large reduction in tariffs here and increased restriction abroad, which should have facilitated European exports and depressed their imports, despite the widespread use of controls abroad to raise exports and reduce imports, despite the much larger rise in money wages here—despite all of these, the United States has been flooded with gold and the world is short of dollars. Europe's failure to cut costs and prices, the absorption of gold by the United States in increased transactions and monetary hoards rather than in required rise of prices, the continued gain of productivity here, the unwillingness to allow Europe to devalue vis-à-vis the United States, the political and military turmoil in Europe with accompanying destruction of industry and loss of foreign earnings, the tendency in an advancing economy to spend more on services and less on goods (and hence less relatively on imports)—all of these and other factors clarify the persistent dollar shortage, but do not solve it.

8. *The Crucial Issue*

We have to export less and import more vis-à-vis the rest of the world. Europe's competitive position and markets must improve. This is the way to solve the problem. But we are not prepared to take the consequences of this policy—and hence increased exports by Europe and reduced imports bring forth pressure to devalue here, agitation for higher tariffs, subsidies to exporters, and so on. This unwillingness to swallow the pill of increased competition from outside strengthens the case for stretching out the adjustment period.

II. *Continued Aid or Trade Adjustments?*

A crucial problem confronting this country is the manner in which the United States will balance its accounts with other countries. Three ways are open to the interested countries. First, foreign countries may restrict their imports and thus save scarce dollars. This is not the best possible solution, for the resulting decline in trade impairs living standards abroad and

deprives exporters in the United States and other dollar countries of markets. Second, the foreign countries may expand their exports and thus earn the dollars they need. European countries are charting their economies with a view to equilibrating their accounts largely in this manner. But cries are already being raised in this country by American export interests and even American import competing industries against the intensified competition from abroad.

The fact is that the American voter shows schizophrenic tendencies in his espousal of foreign economic policies. He does not want to foot the bill as taxpayer and, therefore, wants to terminate foreign aid as soon as possible. But he also resents the dollar deficit being made up by a reduction of sales by American business whether the occasion is a curtailment of foreign imports or an expansion of foreign exports at the expense of domestic sales or exports by American sellers.

For example, before the Senate Appropriations Committee, Senator McKellar, defending the tobacco growers in his state, was indignant that the French would not use E.C.A. funds to buy American tobacco; the typewriter manufacturers, professing strong support for the E.R.P., were equally irritated at the loss of markets in Europe; and Senator Wherry denounced the unfair competition of European textile manufacturers in the United States and elsewhere.[1]

Undoubtedly the unwillingness of the American business man to be ousted from his markets accounts in part for the acquiescence to large amounts of foreign aid. Those who profit from increased sales abroad, and protection of domestic markets, gain more qua sellers than they lose qua taxpayers; and they can make more noise than the large and less vocal group of taxpayers.

I am not implying that the adjustment problems for American business injured by intensified foreign competition are not serious. Those who watch the E.C.A. build up competitive industries abroad which are ultimately destined to take away their markets are indeed not happy at being thrown to the wolves. They are asked to stand by while Western European countries, after a 60 per cent gain in exports in two years (1947 and

[1] *Senate Hearings on Foreign Aid Appropriation Bill, 1950*, June 1949 (81:2), pp. 46, 70-75, 194-200, 340.

1948), are preparing for an equally large proportionate gain in the next few years which will enable them to pay for their current imports. Unfortunately, this will not solve the problem of dollar shortage unless Europe's earnings in non-dollar countries can be converted into dollars, or unless export trade to the United States rises by 300 per cent at present dollar prices. From 1947 to 1952-53, the O.E.E.C. (Marshall Plan) countries propose to raise their exports (1948-49 dollars) to nonparticipating countries $5.4 to $10.6 billion, the proposed rise to North and Central America being from $1.05 to $2-10 billion.[2]

That serious adjustments are required is suggested by the following: Imports of bread grains from O.E.E.C. countries from North and Central America are to decline from $1,216 million in 1947 to $633 million in 1952-53 (1948-49 prices), of meat and dairy products, from $277 to $38 million, of tobacco, from $222 to $151 million. Nor are producers of petroleum products in this country likely to be pleased with a rise of petroleum production for these countries from 102 in 1947 to 463 in 1952-53 (pre-war = 100); nor producers of relevant items in the United States at a rise of production by O.E.E.C. countries of machinery and equipment of 47 per cent over pre-war production; of machine tools, of 39 per cent; of dyestuffs, of 42 per cent; of aluminum, of 110 per cent; of crude steel, of 30 per cent; of cotton piece goods, of 18 per cent.[3]

Over the years 1947 to 1952-53, O.E.E.C. countries seek an expansion of exports of $1.05 billion in North and Central America, $1.25 billion in South America and $1.1 billion in the nonparticipating sterling area. A resultant loss of $1 billion of sales in our market and of $2 billion of sales in other markets to European competitors telescoped within a period of a few years may very well bankrupt many American firms and seriously damage the status of industries dependent upon foreign markets for 10 per cent or more of the markets—for example, fruits, dairy products, bread grains, tobacco, type-

[2] United Nations Economic Commission for Europe, *Economic Survey of Europe in 1948*, pp. 192, 216. Actually, should devaluation reduce dollar prices of Western European products by 20 per cent, the required increase would be 400 per cent ($80 million to $400 million).

[3] *Ibid.*, pp. 182-183, 192.

writers, machine tools, cinema products, textiles.[4] Agricultural industries are indeed not so vulnerable as nonagricultural, for the government is committed to a farm support program at the expense of the taxpayer and consumer. In fact, the widespread support for foreign aid programs in agricultural areas stems, in part, from the favorable effect of these programs on demand for agricultural products.

The effects of the loss of domestic and foreign markets upon American industries is another matter. Even under relatively prosperous conditions, the American *manufacturer* is not likely to stand by as he loses $2 billion of $8 billion of foreign sales and about $3 billion sales out of total sales of $200 billion of manufactured goods. Actually, as we shall see, the adjustments required are much larger.

Perhaps the strongest case for continued financing of the rest of the world through gifts and, better, loans arises from the serious difficulties of the transition of this country from a net exporting to a net importing nation. For example, it may be necessary for this country, with an excess of exports of $11.3 billion in 1947, eventually to countenance an excess of imports of $2-3 billion, the excess of imports to cover payment for financing past loans by this country. *The vast change would reflect the effects not only of Europe's attempts to balance accounts but also those of the rest of the world.* The brunt of the adjustment would have to be borne by the manufacturers who account for $200 billion worth of goods, and the amount involved may be 6 per cent of sales. By continuing the E.R.P. on a reduced level for the years 1952 to 1956 and preparing a large loan program, this country might stretch out the transition from the 5 years now required to 20 to 50 years; but, with the longer period, the ultimate reduction of exports and rise of imports would have to be $2 billion (say) more than in the absence of continued foreign aid or (and) loans.

The difficulties of these adjustments can be exaggerated. From 1947 to 1948, the United States excess of exports declined by $5 billion, or by almost 45 per cent; and at unchanged

[4] Although total export trade was only about 5 per cent of national income in 1948, exports of nonagricultural products were about 15 per cent of income originating in manufactures; and for individual items the percentage was of course in many cases much larger.

prices the decline was at least $6 billion, or more than one half.[5] This transition was, however, achieved in a period of prosperity and rising prices; and in fact the United States government through controls in part forced reductions of exports upon the economy. In general, the problem of wiping out an excess of exports of $11 billion (or $6 billion currently) will not be nearly so serious under conditions of high employment as under those of depression.

III. *Persistence of Shortage of Dollars*

This problem of dollar famine is an old one. Why has the United States exported more than $100 billion of goods (4 per cent of the income of the period) in excess of imports over the last 35 years and received in payment less than one seventh? (I exclude imports of gold which are of little use to us.) [6]

Why do not prices fall abroad and rise in this country, with corrective expansion of exports and declines of imports abroad, and declines of exports and rise of imports into this country? This failure of adjustment is the more difficult to understand since this country, especially in the last 15 years, has experienced a vigorous trade-union movement and rising wage rates; and since during this period the outside world has seriously increased its restrictions on trade while this country has reduced tariff barriers substantially. In the last 10 years, for example, wage rates rose much more rapidly in this country than in Europe; and by recourse to controls and especially exchange control the outside world stimulated its exports and import competing industries. It did not rely exclusively on price adjustments. All these factors should have reduced dollar deficits.

Among the explanations of this apparent failure of Ricardian gold movements to correct the persistent shortage of dollars are the following:

(1) The unusual demand for dollars has been met largely by putting dollars at the disposal of countries short of dollars. Loans in World War I, Lend-Lease in World War II, and various foreign aid programs after World War II are the most important instances. In addition, the large outflows of long-term

[5] *Midyear Economic Report of the President,* July 1949, p. 39. Adjustments for price changes mine.

[6] See my *European Recovery Program* (Cambridge, 1948), p. 15.

capital from this country, and notably in the twenties, provided the outside world with dollars. In so far as foreign countries obtained dollars through gifts and loans, they did not have to bid up the price of dollars and did not have to release gold. To that extent the dollar shortage was concealed and treated, and the required adjustments were not forthcoming. Provision of gift dollars or loaned dollars reduces the pressure to adjust to a weakened international position.

(2) In view of the gold movements of the period, the economist might have expected price adjustments which would have corrected the dollar shortage. Despite large loans and gifts, the pressure on dollar markets was reflected in large rises in the American gold supply. In 1913, gold reserves in this country were but $1.2 billion, or 25 per cent of the world's total. By the end of 1948, this country's $24.5 billion of gold reserves amounted to more than 70 per cent of the world's reserves.

Actually, despite these gold movements,[7] prices did not rise sufficiently vis-à-vis the rest of the world to induce a balance in the dollar account. In Europe the explanation of the disappointing decline in prices was largely rigidity in wage, capital, and government costs and (related) rigidity of prices. The inflowing gold was not, however, sterilized here as has often been contended by European economists. Surely a rise of all bank deposits from $22 billion in June 1914 to $161 billion in December 1948 does not suggest sterilization. The failure of prices to rise adequately is explained by other considerations—note a sevenfold rise in bank deposits and one of but 1½ times in wholesale prices.[8]

Why was the rise of prices in this country so modest? First, because of the much greater increase in product and transactions—thus the gross national product in dollars rose by almost four hundred per cent. Therefore, in part the rise in monetary supplies was absorbed in the demands made by increased output and transactions. In part, the explanation lies

[7] Federal Reserve Board, *Banking and Monetary Statistics* [*BMS*], 1943, p. 542, and *Federal Reserve Bulletin* [*FRB*], August 1949, p. 1008.

[8] *BMS*, p. 17; *FRB*, August 1949, pp. 955 and 989; and Bureau of the Census, *Historical Statistics of the United Sates*, 1949, p. 233.

in the tendency of the public to increase its proportion of cash holdings to national income as the standard of living rises. Whereas the volume of deposits was but one third of the national output in 1914, it was two thirds in 1948. The large rise in monetary supplies, both relative to price movements and relative to output, reflects the large proportionate absorption of cash in an advancing society.[9]

(3) Failure of price adjustments under a gold standard is not an adequate explanation of disappointments with price movements. Countries short of dollars did not have to rely upon direct assaults upon costs in order to depress prices. They could reduce prices of their products abroad (and raise prices of their goods at home) by allowing their exchange rates to fall.[10] Actually, depreciation and devaluation policies have not been so effective as they might have been, *inter alia* because the countries requiring this medicine to correct disequilibrium have not been allowed to take full advantage of their aggressive exchange policies. Consider the American devaluation of 1933-34, which erased part of the gains of European devaluations of the thirties. Domestic pressures might have justified our policies; but our international position did not require a devaluation of the dollar.

Similarly, it is doubtful that Western Europe will be able to solve her current imbalance by devaluations. In part the explanation is that devaluation is of little use unless it is implemented by the measures which will reduce Europe's imports and raise her exports vis-à-vis overseas countries by $5-6 billion, or about 5 per cent of her income. Europe will have to consume less and save more and (or) cut investments by $5-6 billion. A rise of output will help; but only if it is now accompanied by a corresponding rise in consumption and investment. The recourse to the pricing incentive (devaluation) will make it somewhat easier for the planners of Europe to move labor and capital into the required international industries. But if consumption and investment are to be kept in bounds, then prices must not rise substantially. That means appropriate wage, profits, tax and government-spending policies. Whatever the merits of the

[9] *Basic Facts of Employment and Production,* Report of the Committee on Banking and Currency, September 1945, p. 11; and *Midyear Economic Report of the President,* July 1949, p. 87.

[10] *Cf.* my *Exchange Depreciation* (Cambridge, 1936), chapters 1 and 2.

Welfare State, the advance must be slowed up if dollar equilibrium is to be achieved.

Even given the favoring circumstances of increased output, proper monetary, income, tax and spending policies, the success of this new devaluation in solving the dollar problem depends upon extension of European markets and that, in turn, depends upon United States tariff, subsidy and exchange policies. Europeans will not balance their accounts if their efforts to double sales here and, much more important, in other nonparticipating countries are countered by a devaluation of the dollar (1933-34 is a reminder), excessive farm subsidies, dumping of America's industrial products abroad at less than full costs. The dangers here are genuine, especially should depression develop here.

(4) Another and related explanation of the persistent shortage of dollars is the failure of Europe and the outside world generally to capture an adequate share of the United States market. This is in part due to the fact that, with large losses of invisible income, and with large demands for imports because of the devastation of war, the large import requirements of full-employment economies, and (recently) high prices of imports, European exports have to rise greatly vis-à-vis imports. Thus, the British goal for 1952-53 is a coverage of 92 per cent of imports with exports; in 1938, the corresponding percentage was 64.[11]

This failure to capture American markets is in part due to the increased importance of services in the national income. Since, with a rising income, an increasing percentage is spent on services and since services are less important in international than in domestic trade, the gains of imports with rising income are correspondingly disappointing. I do not believe that United States tariff policy, at least since 1933, can largely account for these failures to pierce the American market.

Whatever the explanation, the facts are clear. For example, whereas United States real national production in 1948 relative to 1929 or 1937 rose by two thirds since before the war, imports in real terms rose by but 5 per cent. Again, of $27.1 billion of

[11] United Kingdom, *European Cooperation: Memorandum Submitted to O.E.E.C. Relating to Economic Affairs, 1949 to 1953*, Cmd. 7572, 1948, p. 41; *United Kingdom Balance of Payments, 1946 to 1948*, Cmd. 7648, 1949, p. 3.

United States consumption of 55 manufactured products in 1937, Europe accounted for but $161 million, or 0.6 per cent. The corresponding figure for 1948 is estimated at 0.2 per cent. Again, in the second quarter of 1949, the United States purchased 707 out of 61,300 automobiles, or little more than 1 per cent of the total exported by the United Kingdom. Yet this country accounts for almost one half of the world's income and a much larger percentage of the world's automobiles.

These are serious problems. Europe might expand her overseas exports by 60 per cent and still experience a dollar deficit of $3 billion. Yet all of Europe's exports to the United States in 1948 were little more than $1 billion, and of the United Kingdom, less than $300 million. With a 20 per cent cut in dollar prices, a balancing of dollar accounts would require a rise of 400 per cent in exports to the United States; or, failing that, a very large rise of sales in other overseas markets would be required. Obviously, the major gains would have to be made elsewhere.[12]

(5) Another point of considerable importance in explaining the continued dollar shortage is that even when foreign countries begin to approach the goal of dollar equilibrium, the goal somehow moves away. In part the explanation is the steady relative gain of productivity in this country. Thus, from before the war to 1948, industrial output per man in the United States rose by 27 per cent; in Europe it declined by 10 per cent; in agriculture, the rise in the former was 75 per cent, the decline in the latter even more than for industrial output. (This estimate of 75 per cent by the European Economic Commission is high.) That explains why, though wages in 9 out of 13 countries in 1947 and 7 out of 9 countries in 1948 vis-à-vis 1938 had risen substantially less than in the United States, the average hourly earnings adjusted for changes in output per man had risen 42 per cent in 1947 and 29 per cent in 1948 more in Europe than in the United States.[13]

(6) The position that disequilibrium can continue for long periods of time because the United States maintains technical superiority and advances more rapidly, and because wage ad-

[12] *Economic Survey of Europe in 1948*, pp. 218, 221, Table 16; British Information Service, *Labor and Industry in Britain*, September 1949, p. 141.

[13] *Economic Survey of Europe in 1948*, pp. 107, 226.

justments are sluggish, has become increasingly popular. According to one economist, the varying income elasticities of demand for imports contribute toward this continued disequilibrium.[14]

IV. *Recent Adjustments*

By 1948, Europe's trade, both exports and imports, was below pre-war trade in 1938 dollar volume. Indeed, both exports and imports *in relation to overseas countries* were once more above the pre-war level. In 1948, Europe had reduced its deficit with overseas countries by $2 billion—primarily by a rise of $2.2 billion in exports. An improvement in invisible account (mainly shipping) of $0.7 billion was offset by a rise of $0.9 billion in imports. But the adjustments with the United States did not follow the general pattern with overseas countries: imports from the United States declined by $1.3 billion, and exports to the United States rose by but $0.2 billion. These figures point to the vigorous efforts being made to save dollars as well as to the difficulties of expanding exports to the United States—the latter undoubtedly related to the greater profitability of sales in Europe and other non-European countries. That Europe's industrial production should rise by 16 per cent and exports to the United States remain relatively unchanged —a small rise in exports substantially offset by a rise in export prices—stresses the obstacles confronting Europe in her campaign to sell more to this country. Another way of putting the problem is to compare a rise in 1948 of $9 billion in national income for Europe (excluding U.S.S.R.) in 1947 dollars and an increase of less than $200 million in current dollars and about $100 million in 1947 dollars in the export trade to the United States. The $100 million was about 1 per cent of the gain in national income. In short, Europe (exclusive of U.S.S.R.) used but 1 per cent of her rise of total output to expand exports to the United States.[15]

[14] D. J. Morgan, "The British Commonwealth and European Economic Cooperation", *Economic Journal,* 1949, pp. 307 *et seq.*; C. Kindleberger in S. E. Harris, ed., *Postwar Economic Problems* (New York, 1943), pp. 376-381; also my *Foreign Economic Policy for the United States* (Cambridge, 1948), Part V; and "Dollar Scarcity", *Economic Journal,* June 1947, pp. 165-170.

[15] *Economic Survey of Europe in 1948,* pp. 97, 112, 235.

Even by 1948, Europe's trade (volume), both exports (91 per cent of 1938) and imports (88 per cent of 1938), was still below the pre-war level. Britain's heroic efforts, however, were reflected in a rise of exports of 47 per cent over pre-war exports and a reduction of imports of 20 per cent. By the end of 1948, the British had wiped out a $3 billion deficit that had prevailed in 1947. Whereas in 1947 the British had financed 35 per cent of their investments through an excess of imports, by the end of 1948 they were on their own. *For the entire year 1948*, gifts and loans from abroad and sums realized by sales of foreign assets were but £120 million, or 6 per cent of gross domestic capital formation; in 1947, £630 million, or in excess of 30 per cent. For 1949, the forecast was exclusive reliance on domestic savings.[16]

Figures below show both the large gains of the United Kingdom in pushing exports to overseas countries and the general pressure in Europe to restrict imports from the United States and overseas countries. This is a pressure which, as already noted, vexes American export interests; but in a highly inflationary economy the damage was not so great as it would be under depressed conditions.

TRADE RELATIONS OF EUROPE AND OVERSEAS COUNTRIES

Volume—1938 = 100

	Exports to		Imports from	
	1947	1948	1947	1948
1. United Kingdom				
Vis-à-vis Canada and United States	95	128	126	86
Vis-à-vis all overseas countries	115	145	100	98
2. Europe				
Vis-à-vis Canada and United States	70	91	192	137
Vis-à-vis all overseas countries	81	105	114	107

Source: Adapted from Economic Commission for Europe, *Economic Survey in 1948*, pp. 66-67.

Plans of the O.E.E.C. countries reflect continued efforts to cut imports from this country; and once more point to the important decisions that will have to be made in the next few years. Although total imports (constant prices) of these coun-

16 *Ibid.*, p. 58; *Economic Survey for 1949*, Cmd. 7647; *National Income and Expenditures of the United Kingdom, 1946 to 1948*, Cmd. 7649, p. 17.

tries are to rise, their imports from North and Central America are to decline from $7.3 billion in 1947 to $3.8 billion in 1952-53, a decline in volume of 48 per cent of 1938.

From 1947 to 1952-53, exports from O.E.E.C. countries to the outside world are to rise from $5.4 to $10.6 billion; those to North and Central America are to rise from $1.05 billion to $2.1 billion. The United Kingdom anticipates $1,455 million of exports and reëxports to the Western Hemisphere for 1952-53, or $800 million or 120 per cent above that of 1947. Of this rise, the United States is to account for $145 million ($195 to $340 million). Imports from the Western Hemisphere over this period are to decline from about $2,900 to $1,900 million.[17]

According to the Economic Commission for Europe, Europe's exports expanded by 30 per cent per annum over the years 1947 and 1948. An increase of similar proportions in the years 1949 and 1950, plus an improvement in invisible transactions of $600-800 million, would balance Europe's international accounts. When viewed in relation to a 10 per cent annual rise of industrial output in the last few years, the amounts do not seem very large. Overseas exports were but 15 per cent of Europe's industrial output. Crucial would be the movements in terms of trade. In 1948, the improvement would have been, not $2 million, but $3 million, had not terms of trade deteriorated. Another adverse movement of 10 per cent would require a rise of exports of 30 per cent additional.[18]

V. *Conclusion*

The main points to be emphasized are the following:

(1) If the heavy burden of adjustment is not to be concentrated over a short period of time on a limited segment of American economic life, there will have to be continued loans and (or) aid long after 1952. The only other alternative is a drastic cut in imports by Western Europe which would have serious economic and political repercussions.

(2) The major gains in European exports will have to be made, not in the United States market, but in those of third

[17] *Economic Survey of Europe in 1948*, p. 191; and United Kingdom, *European Cooperation: Memorandum Submitted to O.E.E.C.... 1949 to 1953*, pp. 41-43.

[18] *Economic Survey of Europe in 1948*, pp. 211-213.

countries. Hence the pressure will be felt much more by United States exporters than American sellers in the United States markets.

(3) Dollar shortage is an old problem, which is not likely to be cured overnight. Indeed, important gains were made in 1948; but a solution of the problem awaits competitive gains by Europe, diversion of adequate resources to export and import competing industries, and the opening up of new markets. The more favorable economic conditions in dollar markets, the easier the expansion of European exports, and the less damage to American business men ousted from domestic and foreign markets.

REMARKS BY THE CHAIRMAN

CHAIRMAN BIDWELL: Thank you, Mr. Harris. Mr. Harris has helped us a great deal in the understanding of the purposes of the foreign aid program and the obstacles which have to be overcome. I cannot say that he left us in a very optimistic mood. Evidently this business of helping Europe is going to cost us more than we anticipated.

We shall be interested to learn whether Mr. Thomas Blaisdell, our next speaker, can lift us from this slough of despond. Mr. Blaisdell is now Assistant Secretary of Commerce. Before he took this position, he was Director of the Office of International Trade. His interest in foreign affairs goes back a long while. As a teacher, he began his career in India, then taught in China, and came back to the United States to teach at Columbia. When we took a tailspin into depression, he was among the economists who were brought to Washington to help government and business get out of their troubles.

He stayed in Washington, having had positions of increased responsibility until he is now, as I have told you, an Assistant Secretary of Commerce. His present position followed an assignment in London as Chief of the Mission of Economic Affairs, with the rank of Minister. We are going to be greatly interested, I am sure, to hear what Mr. Blaisdell has to say on "Foreign Aid and United States Commercial Policy".

THE FOREIGN AID PROGRAM AND UNITED STATES COMMERCIAL POLICY

THOMAS C. BLAISDELL, JR.
Assistant Secretary of Commerce

SCIENCE is always producing new wonders. We have read in our popular magazines recently of a new kind of glass. When it is used as a window, one can see out but no one can see in. Whatever the scientific basis for this new invention, to the layman this one-way glass is a wonderful invention.

To those, however, who have some understanding of human behavior, being able to see in only one direction is no new phenomenon. We are quite accustomed to looking out at the world from our own viewpoint and yet being unaware that people elsewhere may have an entirely different view from our own. The inability to see two ways in matters of commercial policy is historic. It is not limited to people in the United States. It applies equally to those in other nations. This human failing is particularly noticeable in matters of commercial policy, inasmuch as the essence of trade is mutual interest and a two-way benefit. The seller should be able to put himself in the place of the buyer, but strangely enough this does not appear to be easy.

As a nation, we tend to forget that, if we are going to sell, we must buy. Exports must be offset by imports. This is the rule of trade, and I have no intention of elaborating on it. I do, however, wish to emphasize that, in building the structure of our commercial policy, we need to install two-way glass. Without it, we will find ourselves adopting policies which will close our markets to others and eventually close their markets to us.

The Marshall Plan is a dramatic attempt to bridge the economic gulf that separates us from the nations of Western Europe. It is important to review the commercial policy objectives of the Marshall Plan and to determine what progress we are making toward building a commercial system that will bring mutual benefits to all trading nations.

While the monetary and physical aid of the assistance program has been given much publicity, the more permanent parts of the program have tended to be overlooked by the public. The important question is, what will remain when the program of aid is finished? From the beginning, those concerned with policy have been concerned with the permanent as well as the temporary results.

The immediate result has been recovery. The permanent result will reveal itself in the kind of trading world we have built. Will we have a world in which buying and selling can take place freely? In which investment can be made with confidence internationally as well as nationally? In which steady levels of business activity have replaced the international boom-and-bust of pre-war years?

With regard to our foreign aid policy, we have no desire to continue grants-in-aid in the maintenance of international trade. By the same token, the countries now receiving aid have no desire to continue receipt of that aid. It is vital to the stability of our economy and vital to the economies of the countries now participating in the economic coöperation program that this post-war device be recognized as a temporary device. This has been said many times, but all programs tend to become self-perpetuating, unless they are handled with great care.

In the early days when the Marshall Plan was first discussed, commercial policy was in the forefront of the discussion. The way in which the program was to be carried out would make or break it. The way in which the goods were delivered would have great influence on the future of all our commercial institutions.

Normal international trade almost ceased to exist during the war. As far as the movement of goods between the United States and Europe was concerned, almost all of it was carried on as a Lend-Lease operation. The transactions were between governments. The physical movement was dictated by the availability of transportation facilities. Business costs and competitive relationships were completely forgotten. The important thing was to move the goods by the shortest physical route, even though manufacturing costs and ultimate delivery costs were high. Reverse Lend-Lease was operated on the same

principle. The objective was noncommercial—namely, winning a war. The policies which dominated, therefore, were those of logistic efficiency and not commercial or business profit.

In certain parts of the world, where trading had been carried on on a somewhat more normal basis, large indebtedness was built up. Thus, Latin American countries had acquired large amounts of dollar exchange. They were unable to use this exchange during the war, for export controls had prevented the sale of goods from the United States. Likewise, heavy sterling indebtedness had been created by the British in India and the Near and Far East. When the war was over, both the governments and private citizens tried to use this currency.

The inability to supply goods readily as a result of the postwar shortages meant that this foreign demand acted as an inflationary force on our economy. Likewise, the demand on the United Kingdom of those countries which held sterling, particularly the demand from India, Pakistan and Egypt, has created pressures on the economy of the United Kingdom which have been contributing causes of the recurrent crises.

When the war ended, the disruption of the normal channels of trade had been tremendous. Buying and selling by governments, even in the United States, dominated fifty per cent of the economy. It is reasonable to say that half our purchases at that time were being made by government, for either military supplies or Lend-Lease. The purchases made by the British government were roughly in the same proportion. All the nations who were taking part directly in the war were forced to follow this kind of national policy, since the government was the main channel through which the strength of a nation was brought to bear on the enemy. Even private activity in the commercial field, such as remained, was hedged around by restrictions so that private business, whether domestic or international, hardly recognized itself.

It was necessary, if we were to have an international trading world again, to rebuild much of the business and certainly the business connections which had been broken as a result of the war. Obviously, the smaller concerns had suffered the most. The larger concerns, with more resources and ability to main-

tain skeleton forces, at least retained their sinews in something like workable condition. But the international trading system which we had known between the wars was no longer in existence.

Since 1945 we have been slowly and painfully rebuilding. The readjustments which have been taking place have been extensive. Many American firms which had never been in the international trading business found a profitable field to operate in, even with little experience and with little training. The demand for goods was such that anyone who had goods could sell them without difficulty. So, when the first attempts were made to reëstablish what we shall call normal trading channels, the commercial policy as represented by the loans to Great Britain and France at the time of the Lend-Lease settlements rested on the conviction that the commercial world, given funds, could quickly move back to the kind of world we knew before the war. How badly the situation was misjudged is now common knowledge.

Everyone here and abroad had misjudged the extent of the destruction of the production and trading facilities. Responsible people in government, informed business men, bankers, big business, little business, even the academicians, who presumably from their points of vantage in ivory towers are able to see things which other people cannot see, apparently were unaware of the major changes which had taken place, and of the size and complexity of the reconstruction program.

However, by the time the Marshall Plan was under discussion, the question as to how goods were to move to Europe was an important issue which received much attention. Were we to use normal commercial channels, or should we apply the principles and methods of Lend-Lease?

There were many who had been impressed by the physical efficiency of the wartime movement of goods. They thought of the post-war period as an extension of the wartime situation—a situation in which shortages dominated the scene and allocation of goods for export from the United States was taken for granted. Those goods which were most particularly needed in Europe were those which were also most desired in the United States. The negotiations between the European governments

and the United States were in essence an appraisal of total economies and their relationship to each other. This again was a carry-over from wartime thinking. Had the time come when it was possible to have confidence that private international trade could carry the responsibility for a major job of reconstruction?

There were those who knew that the job was not a relief job, that relief had been taken care of and that the time had come when the peoples of Europe were prepared to assume responsibility as individual workers in individual businesses, rather than ask their governments to assume responsibilities beyond the strength of those governments. We will find, if we trace this history—which is only two years old—that everyone was agreed about the desirability of private trade, but a great many had doubts as to the capacity of private trade, here and abroad, to carry these responsibilities.

The policy decision which was finally taken and written into the original statute, under which E.C.A. now functions, provided that private channels of trade should be utilized "to the maximum extent consistent with the accomplishment of the purposes" of the Act. These words are easily recognizable as a postponement of the decision on private trade. In fact, there was so much conviction, both in the business community and in some parts of the government in Washington, that private channels were impracticable for the purpose, that some of the best-informed writers of confidential letters to business men sent out authoritative information to the effect that practically all the E.C.A. program would be carried out on the basis of government transactions. The early weeks and months of administration of the program were taken up with dispelling this false idea. From the beginning, private trade provided the mechanism for moving most of the goods and services which were involved in this program.

I trace this history only because of its importance to an understanding of the way in which recovery has taken place. The decision that we would depend upon the machinery of private trade to carry out the commercial side of the program was crucial. It was an expression of faith that private trade could do the job. It was also an expression of our desire and deter-

mination to rebuild the world trading machinery which had been destroyed by the war.

It is of further importance to note that this program was carried out in the face of strong movements in Europe which relied heavily on the intervention of governmental authority. But the post-war European governments, with a few outstanding exceptions, have had to be rebuilt from the ground up.

The contacts and friendly relations which make up business organizations, government bureaus, courts, schools, all of which embody a way of living, had been disrupted and could no longer be counted on to function with their pre-war vigor. However, it was not surprising that the people failed to understand this, and expected their governments to perform impossible tasks. Almost every government of Europe assumed major administrative responsibilities which, even before the war with a smoothly functioning society, it would have assumed only with great hesitation.

That the governments have been unable to carry these responsibilities as efficiently as we might like should surprise no one. The surprise should be that they have functioned as well as they have; and how well they have functioned is shown in part by the magnificent record of productive achievement. The record is a credit to the governments as well as to the workers, the farmers and the business men. Pre-war production has been surpassed in practically every country, on a time schedule far ahead of that which was achieved after World War I.

In one sense, the recurring crises have been crises of success rather than crises of failure. The achievements in production have moved ahead more rapidly than the achievements in the field of trade. Commodity markets are not functioning smoothly. Monetary adjustments are still to be made before the exchanges can operate efficiently. The conditions necessary for investment have not been established.

A second major matter of commercial policy which was recognized in the original discussions of the aid program was the problem of investment in relation to trade.

When a steel mill is sold abroad by an American company, the transaction appears as a normal trade transaction. Somebody buys a steel mill, and somebody sells one. The shipment

of parts takes place over a period of months. But the transaction has entirely different overtones if an American company builds a mill abroad which it will own and operate. This is an American investment and represents the movement of American capital. But most people forget that the export of capital goods is a normal part of trade. The only essential distinction lies in the ownership of the goods moved.

The Marshall Plan has taken care of a crucially important part of the consumption requirements of Europe. This should free much European capital for the rebuilding of productive equipment. Indirectly, our government-to-government grants-in-aid have been a capital investment in basic European development. However, under normal economic conditions, international grants or loans have been of small size and most capital movement has been on a private basis.

The problem of restoring private capital movement was recognized in the original E.C.A. legislation. There was a section of the Act, little noted, which provided for the guarantee of at least a partial return of private foreign investments participating in the program. This provision has been little used, and even under a recently broadened and more liberalized administration has had slight effect. This is not surprising because the guarantee can deal with only part of the problem.

The policy of encouraging foreign investment has many facets. I mention it here since I am concerned with its relation to the commercial policy and the foreign aid program. Just as the commercial institutions associated with private trade were destroyed during the war, the investment banking functions, and particularly those associated with foreign investment, were disrupted. Many of the partners in the principal firms, and their staffs, were found during the war holding responsible positions in the fighting forces or in government agencies. This was true in all countries concerned with foreign developments. In London, which had formerly been the world's center of foreign investment, many of the firms were broken up. Many gave their full complement to the demands of the war. The restoration of that machinery and the rebuilding of the sources from which it drew funds have only slowly been taking place.

Likewise, at the other end of the receiving line, those countries in which investment must take place have been slow to recognize the basis on which investment, technical knowledge and productive skill can be transferred from one economy to another. Slowly we are learning again that, just as in trading there has to be a buyer and a seller, when it comes to investment there must be a borrower for every lender.

A third matter of major policy, which was never expressly mentioned in the legislation, has to do with the consolidation of the European trading area. There are many different conceptions of this consolidation, both in the minds of Europeans and in the minds of Americans. And there are almost as many reasons given why it is impossible to carry out such a policy as there are ways suggested of accomplishing it. Nevertheless, it remains a commercial objective.

In the last few days, Mr. Hoffman has been talking with the Organization for European Economic Co-operation in a further effort to clarify what is meant by consolidation. He has made it clear that, by integration, the United States does not mean rationalization or cartelization, that private monopolistic understandings are no more a part of our commercial policy in Europe than they are in the United States. But we are concerned with finding ways to broaden markets, to simplify trading, to harden currencies, to lower customs barriers.

We watch with sympathy and applaud the actions of the Dutch, the Belgians and the Luxembourgers as they take the last steps in the direction of a customs union. We have been impatient to know why other countries do not take similar steps. Even in our impatience, however, we recognize that these are matters which must be decided in accordance with European ideas and not solely in accordance with our own. We recognize our interest in these problems, but we have no desire to dictate their solutions.

The thinking concerning consolidation has gone well beyond commercial policy. It has been applied to the international control of resources, as in the Rhine Authority. It has been applied to monetary union, coördinated military planning, and even political union. From this multitude of ideas, it is impossible at this date to know what the developments will be.

Those Americans who have strong feelings about European union, along with many Europeans, are more interested in a sound program of lasting value than in hasty steps that are dramatic but unrealistic.

Part of the essential bargain contained in the American offer of aid was mutuality. If the European nations helped themselves, we would be prepared to participate. Their first major action was one of common effort and common appraisal of mutual difficulties. Following their action, we sat down with them for further joint appraisal, and day by day, month by month, since that time the coöperative work has gone on.

The mutuality of trade policy between countries must be recognized. I mentioned, in the beginning, that commercial policy looks different as we look out from the way it does to those who are looking toward us. As we look abroad, we see export controls, import controls, quantitative restrictions in the application of both of them. We see tariffs. We see exchange controls. We see multiple exchange rates. We see currency manipulation. We see subsidies by other countries. All of this, we say, results in discrimination against American business and makes it impossible for American traders to compete in what they properly regard as legitimate markets. It is difficult for us, as we see these conditions, to understand that, as business people in other countries look at us and our economy, they see high tariffs, customs restrictions, import controls, export controls, subsidies to agricultural commodities, subsidies to our merchant marine, subsidies to our international air carriers. And, they say, this is unfair to their business men.

We are inclined to put our emphasis on a demand for removal of restrictions by other countries. They, in turn, have been inclined to see only the difficulties which we impose on them. This is only natural. But while we each see the restrictions the other has imposed, the countries associated with us in the aid program have a common major objective with us.

Western Europe as we know it cannot survive except as a part of a world trading community. This is a community in which private investors and private traders carry out the major economic activities. Even if we grant the necessity for government regulation in many spheres, and recognize that govern-

ment functions are essential—and I think there is no one who would deny this—it is obvious that this world trading community has to be rebuilt, and that the principal parts of it will be the countries of Western Europe, the British Commonwealth of Nations, the United States, the countries of South America and Southeastern Asia, and Japan. The countries to the east of the iron curtain have apparently decided on building a world of their own rather than dealing in anything but a peripheral way with the world trading system.

There is, however, the necessity that all parts of the world trading system recognize their mutual dependence on each other. The countries of Western Europe are peculiarly dependent not only on the United States, but on other large parts of the world. Likewise, the United States becomes increasingly dependent upon the rest of the world for the kind of economy we have.

The mutuality of our commercial interests, the interdependence of all countries in the world trading system, require an understanding of the way in which the system works. Because it is a world system, because none of us can know all there is to know about the world, because it is a system, yet because it has been dependent on the activities of many individuals, it is hard to conceive, and harder to rebuild.

In discussing the rebuilding of the world trading system which has been a major objective in the aid program, I have emphasized the mutuality of private trade, of private investment, and of consolidation of the European trading area. But the problems are wider than Europe. They call for machinery which will strengthen the old system and improve it. They call for mutuality with other than the European nations. Hence, we have the International Bank for Reconstruction and Development, the International Monetary Fund, and the proposed International Trade Organization. They were to provide the forum within which the problems of world trading could be threshed out on a mutual basis.

We do not yet know how to use these instruments efficiently. Those who support them sometimes forget there are other powerful and strong private institutions outside of these intergovernmental bodies which must be recognized and supported with as much vigor as they support the international organiza-

tions, if the organizations are to survive. The Fund, the Bank and the International Trade Organization are not planning organizations which will dominate the world. They are organizations for consultation between the nations which are established on the principles of freedom of political activity, freedom of economic activity, freedom of conscience, and human dignity.

The aid program is temporary. A commercial policy founded on principles which have motivated the program can be lasting.

Remarks by the Chairman

Chairman Bidwell: I think my prediction was right. Mr. Blaisdell has given us a somewhat more optimistic outlook on the foreign aid program and our present economic difficulties.

I now have the pleasure of introducing Dr. Alexander Sachs, who is well known, I think, to a great many of you here. He describes himhelf as a practical economist.

Dr. Sachs was for some years Vice President and Adviser to the Lehman Corporation. He is still a director of that corporation. During the war, he was Economic Adviser to the Petroleum Industry War Council of the British Empire and received a decoration of the Order of the British Empire in recognition of his valuable services to that organization. Dr. Sachs!

RESTORING THE ECONOMIC-CULTURAL BASES OF AMERICAN FOREIGN INVESTMENT

ALEXANDER SACHS
Independent Economic Adviser and Industrial Consultant

Introduction

IN the manner of instrumentalists tuning for a new with a chord or two from old compositions, two texts are submitted for self-attunement to an inquiry into the bases of world reconstruction, that is overwhelming in its pervasive gravity and ramifying complexity. The first is related to the mood in which the inquiry should be keyed, over against a too prevalent underestimation of the novelty of the intractable problems and accepted procedures by fragmentized expertise based on unexamined presuppositions. The key is given by an ancient composition:

> Thou hast made thy people to see hard things;
> Thou hast made us to drink the wine of bewilderment.[1]

The second, referring to method, underlines the needed departure from facile oversimplifications translated into sloganizable programs, which when proved inadequate—as penetrative analysis could have initially disclosed—tend to be replaced by others of a similar nature. With respect to method, then, a dictum and admonition are submitted from a profound scientific thinker turned philosopher and cultural historian, the late A. N. Whitehead: " Seek simplicity, and distrust it."

As to mood, ours has become an age that can no longer take things easily, on the assumption that predetermined trends operate on their own and in the right direction. Intense and unremitting anxiety is a salient characteristic of reflective to popular contemporary thought. It is reflected in a literature that, starting from the Continent has resurrected and made a living force of Kierkegaard, the theologian of *Angst* (anxiety), born a cen-

[1] Psalms 60: 3.

tury ahead of his time. Similarly it is reflected in Protestant religious thought since the Great Depression that has taken a former specialized economic-financial term and developed the "crisis theology". And of late it has influenced social and political thought through the revival of a concept of the break-up of norms of belief and conduct, designated by the term "anomie" invented at the turn of the century by the sociologist Emile Durkheim. Thus in a book published last year by Sebastian De Grazia, the nature of the political community is analyzed negatively in terms of "the causes and consequences of the disintegration of political belief-systems," for if men "allow opposing directives to sway them . . . they have no political community: they have anomie."[2]

Contrast this mood of ours with that of the post-Napoleonic generation at a corresponding point in the last century. Of that generation Professor E. L. Woodward observed: "Few people born in 1850 would have chosen, even upon a slight knowledge of the facts, to have been born a half century earlier."[3] Contrast it, too, with that in the aftermath of the First World War. That post-war period was contemporaneously regarded as definitive peace and the prior war was interpreted as a nonsignificant interruption of the course of progressive civilization, as attested to by Lord Bryce's identification of the world position in 1921 with "the universal acceptance of democracy as the normal and natural form of government."

Yet for all of our perplexities, the at once distinctive and salutary fact about the present is that we have not been unnerved —that we are using our perception of the "hard things" mentioned in the quoted verse for carrying forward the banner of our way of life mentioned in the very next verse. So at the other end of the bipolar truth about the bewilderment are the active responsibility for and the notable progress in "healing the breaches" as mentioned in the prior verse.[4]

The continuing difficulties are that in a world of galloping problems and overlapping pressures, on the one hand, policy-

[2] Preface and page 189 of *The Political Community* (Chicago, 1948).

[3] Penultimate paragraph of the *Age of Reform, 1815-1870*, by E. L. Woodward, vol. XIII of the *Oxford History of England* (1938).

[4] Psalms 60: 2-4.

making is carried out under klieg lights of publicity without adequate preparation, and, on the other hand, the public is subjected to bombardment by particles of intellectual fission from masses of books, articles and broadcasts by publicists and social scientists, adjusting their analysis to issues in their evanescent or specious present forms. At the same time, the high officials, augmented by executives drawn for intervals from private life, translate and adjust these policies in the hope that the inadequacies which they recognize in the means adopted will not overtake their term of office, and proceed on the assumption that sufficient unto the day is the postponed or glossed-over crisis thereof.

Accordingly, a counterpointed attempt is made herein to deal with questions and presuppositions that have been left inarticulate in the process and to provide both historic perspective on, and close-up appreciation of, the issues and the proposed solutions in the full interplay of the structural changes and the plastic potentials available to both public and private interests. Now that the international rescue work has progressed sufficiently to afford us a time-loan for thought, the occasion should be utilized for creating the preconditions for long-range and cumulative international investment not merely by American nationals, but by the nationals of the aided countries that, due to the lack of preconditions, have been involved in the tremendous capital flight that has accumulated since the short-of-peace prewar period of the Thirties. Just because this post-war period calls for a new construction under conditions still short-of-peace, with attendant unparalleled national defense and other burdens, the task cannot be effected merely by substituting government for individuals. For under our system the public behind that consolidated corporate body, called in English and American constitutional and financial history Public Debt,[5] has (a) to be convinced regarding the traceable economic productivity and liquefaction of capital invested, (b) to be accorded the protection of equality and equity of treatment for accumulated and accumulating American investments, whether by indi-

[5] The distinctiveness of Public Debt as a legal-political concept appears to have been first noted by the legal historian, F. W. Maitland, in an article at the beginning of the century on "The Crown as Corporation", reprinted in his *Collected Essays* (1936), pp. 114-115.

vidual nationals or the total body politic, and finally (c) to be reassured regarding the development from the start, in conjunction with foreign nationals of experience in such developments, of a workable order of shared rights as well as obligations, and economic opportunities as well as great common causes.

Part I

Lights on the Economic-Cultural Reference-Frame of the Post-War Problems of International Trade, Investment and Reconstruction

The thesis implicit in the orientation upon the problem as already defined is that much more than economic disruption and destruction is the legacy of the war, and that much more than a successor to the nineteenth-century leader of international investment is now required. Nor does the current emphasis on industrialization of undeveloped or underdeveloped areas warrant any facile inference that the primacy of attention and concern can be shifted from the British Commonwealth and Western Europe, and that development schemes can safely proceed on the type of bilateral basis apparently favored by certain organs of our government and international agencies in place of conjoint operations with the Western Powers and their nationals who, through the ordeals of experience, have acquired a " know-how " and a " know-that " beyond the ken of neophytes of the East and the West.

* * * *

Proceeding with positive characterization, the present post-war period needs to be regarded as the culmination of interacting developments on *four dimensions,* which developments in their aggregate and cumulative impact upon contemporary history are without parallel.

(1) The first is the counter-imperialism movement and transfer of authority and direction over vast resources under (a) the impetus of the Western doctrines of liberty and consent of the governed that have been implemented progressively within the Great Western Society, and (b) the reactions of the ruled peoples to the very cultural influences of Westernization and derivative nationalism.

By way of highlighting the importance of the Far East—which, on the one hand, has been neglected by some economists pursuing globalist solutions through *ad hoc* economic federalism, and which, on the other hand, has been misinterpreted by some Western "experts" on the Far East bemused by their adopted altruistic chauvinism in behalf of the emergent Eastern nationalisms—it will suffice to draw attention to the ramifications of two simple facts. First, the dollar income to Britain and the sterling bloc from the industrial raw materials of Malaya and adjoining areas, before the war, on the whole exceeded that of the United Kingdom's exports of manufactured goods to the United States. Yet in the recent emphasis on the high prices and differential costs of British exports as soluble only through devaluation, there was virtually total ignoration of the elementary fact that, with respect to the other half of the dollar income, prices not only were not inflated, but were below the pre-war level. In the statement issued in November with the report of the Kamuning (Perak) Rubber and Tin Company, Sir John Hay recalled that in the Agreement of 1939 with the United States for an exchange of rubber into cotton, ninety thousand tons of rubber were sold for six hundred thousand bales of cotton, and he calculated that the same quantity of rubber today would be worth at the present values less than two hundred thousand bales of cotton. Yet under the war and post-war food price inflation, the cost of living is about three times higher than before the war, and wages have accordingly been paid at a rate that takes full account of this rise as well as a far from negligible increment of improvement in labor's living standard. In face of an absolute decline in the price of rubber since the pre-war period, the operation could continue only through the adoption of new techniques in tapping, cultivation, and general maintenance. The inadequacy of dollar resources from that coeval area thus stems from a distortion of values, due to our enforced restrictions on the use of natural rubber in favor of the synthetic product.

Similarly, in the post-war struggle between certain Javanese nationalist elements—seeking complete control over the whole of Indonesia—and the Dutch government—seeking to restore elementary law and order and to work out a federalist solution in

keeping with what it deemed to be a concert of its own and of the native interests—the American proponents of the Indonesian nationalist case, and our publicists generally, neglected the economic importance for the Far East and the world economy of a cohesive Southeast Asia functioning in coördination with the West. The economic complex of Indonesia and six other countries—Malaya, Indo-China, Siam, Burma, Ceylon, and the Philippines—through the centuries of the modern era have been in active trade with, and influenced by, the West, and they lie athwart strategically important lines of communication and cover important trade routes. In the aggregate these seven countries with one hundred and fifty million people exported in the pre-war years twice as much as China and India with nearly nine hundred million inhabitants, or, on an equated population basis, their international trade was a dozen times as important as the subcontinent of China and India.

(2) The second dimension is the contraction of geographical scope and diremption of the fabric of economic interchange between the economic complementaries of Europe—even as compared with the aftermath of the First World War—by reason of the Soviet-generated schism within Europe and the engulfment of Southeastern and part of Central Europe by Russia as the Byzantine totalitarianism and heir, by tactics of deception and aggression, in this post-war time to parts of the former Ottoman Empire, that were liberated by the West in the nineteenth century.

While the delineation of the European trading economy is too extensive and complex for presentation at this point, here, too, a single simple fact may throw into sharp relief the change effected by the Second World War. Due to the tremendous emotional investment that the intelligentsia has had in the Russian Revolution and Soviet Russia, the intelligentsia's espousal of the doctrine of self-determination did not include the territories which seceded from Russia near the end of the First World War—Eastern and Central Poland, Finland, and the three Baltic states. The immediate neighboring small peoples with their population of twenty-five million did, thanks to their independence and Western orientation, improve somewhat their living standards and raise markedly their contribution to international

trade. Indeed, according to one authoritative compilation, they contributed more to international trade before the war than the one hundred and seventy million inhabitants of the Russian Empire.[6]

The primary cause behind the second dimension, and the contributive cause behind the first dimension, is the Soviet systematic obstruction of peace. What before the end of the war this writer designated as an inevitable emergence of a short-of-peace post-war period has been manifested in the following: (1) the annexations of the three Baltic states and Eastern Poland without any formalities; (2) the practical absorption of the neighboring successor states of the former Austro-Hungarian Empire; (3) the civil war in Greece; (4) the civil war in and control of China, save for strategic Formosa; and (5) the splitting of Germany and the reduction of Eastern Germany to satellite status. In our eagerness to proceed with the economic implications we cannot pause to complete the descriptions, and must instead note that American and Western statesmanship have responded with counter-strategies and have not only progressed with European recovery, but checkmated the Soviet in the Balkans and partly in Germany. All the same—and this is vital for the evaluation of the outlook for capital and investment operations—this is what Hobbes called " war weather ", to recapture a submission that this writer had made in the Thirties regarding the nature of the Nazi piecemeal aggressionism:

> For war consisteth not in battle only . . . but in a tract of time wherein the will to contend by battle is sufficiently known . . . . For as the nature of foul weather lieth not in a shower or two of rain but in an inclination thereto of many days together, so the nature of war consisteth not in actual fighting, but in the known disposition thereto during all the time there is no assurance to the contrary.[7]

Applying this to the difference between the present and the first post-war period, the unavailability now of a state of peace has carried forward the insecurity and flight of capital that obtained in the decade prior to this war.

[6] On the calculations by V. Raud, the share of the Russian succession states in world trade in 1938 was 1.65 per cent over against Russia's share of 1.1 per cent. (*The Smaller Nations in the World's Economic Life*, p. 21.)

[7] Thomas Hobbes, *Leviathan*, Part I, chapter 13.

The foregoing evocation of the impact upon our Allies of the dual forces of the crumbling of the imperial order and the contraction of the European Continent can be further illustrated through the nature and the preponderant cause of the deficit in the international balance of payments of the leading Power of Europe, the United Kingdom. From a comparative analysis of the total trade and related international transactions of Great Britain in the first two years of the present post-war period, 1946-47, alongside the corresponding years of the first post-war period, 1919-20, it turns out that the excess of imports this time was fairly close to that of last, namely around half a billion pounds sterling (more precisely £653 million for 1946-47 against £563 million for 1919-20). But whereas in the two years following the First World War the income from international services, chiefly shipping, and from international finance, chiefly income from investments, sufficed to offset the passive trade balance and leave a surplus of £70 million, in the first two years after this war the two main international service and income items were only a third of those of 1919-20, and the responsibilities of the unfinished pacification involved the government in expenditures of another half a billion pounds, so that in the aggregate, instead of a slight margin, the total deficit on current account was augmented to over a billion pounds.[8] A similar tabulation could be made for Holland in particular, as another one has been made for Europe as a whole, exhibiting that the deficit in the current post-war period was one and one-half times that of the aftermath of the First World War. The practical moral that can be drawn immediately is that, however desirable the deepening of economic interchange between the European countries—for which the term " integration ", with its overtones of cartelization to European ears, is quite misleading—the restoration of economic-financial solvency to Europe requires (a) repairing of the fabric of Europe-Amerasian trade, (b) the acceleration of improvement of the Western European economies related to a rationalization of not merely the quotational levels of currencies, but more fundamentally of the financial bases of credit and investment, and (c) the reoriented pursuit of devel-

[8] From a compilation by the Research and Planning Division of the Economic Commission for Europe included in the *Survey of the Economic Situation and Prospects of Europe* (Geneva, 1948), p. 60.

opment in underdevelopd areas through conjoint American and European economic financial interests, with governments serving as fosterers instead of substitutes for entrepreneurial and investor groups.

(3) The closing illustration and application just given of the import of the post-war short-of-peace as the continuation of the pre-war short-of-peace that was induced by Nazi cumulative aggressiveness lead into the consideration of the impairment during the pre-war decade of the bases of international investment. What, in the wake of the Great Depression, was a series of defensive operations by individual countries, after resolute attempts from 1929 to 1931 to meet the charges on their international obligations as well as deficits on other international payments, became, with the advent of the Nazis to power, a spreading infection from the Nazi techniques of trade bilateralism, exploitation, and spoliation of foreign capital. Nazi Germany, while pretending to remain technically on a gold basis, developed what this economist contemporaneously called the " golden fleece standard ", fleecing the raw-material countries of the Balkans and Latin America that were trying to find outlets for surplus commodities, and fleecing the holders of German bonds and other securities that had been floated in the Twenties through security repatriation schemes whereby German exporters could share with the government in the profits of repatriation. As an extension of Gresham's Law, not only was the bad money from these multiple currency arrangements driving out the good, but the bad practices came to be emulated by other countries. Thus we have been witnessing writ large throughout the network of international economic and financial activities the truth of the French aphorism, " The worst is the friend of the bad."

As the crisis from the Depression passed into the crisis of the pre-war period, then of the war, and of the post-war years, the process of devaluation and debasement of currencies extended to the whole complex of international interchange and communication in the cultural as well as economic sense. Thus, on emerging from the war, even those countries that were enriched, instead of reviewing their international investment positions and effecting just settlements, continued their pre-war positions. An important corollary development within the comity of our

Western society has been a decline of concern not only for the rights of international investors, individual and corporate, but for fair treatment to internal investors in enterprises that were taken over by governments.

So important is this phenomenon of the degradation of international standards, the normlessness or " anomie " alluded to in the Introduction, that it is necessary to pause longer over it in order to dispel a too facile and fallacious notion that this can be resolved by a system of guarantees of investments. In keeping with our alternation of penetrative analysis of the political-cultural forces and their economic-financial results, it is submitted that just as in internal finance the restoration of soundness requires an act of will prior to the designed mobilization of the means, so inherent justice and practical expediency call for a recall to moral order and practical sense.

The interconnection that we have adumbrated herein—in the absence of space and time for articulated portrayal—between international-political, economic, and cultural trends in a time tract of the disintegration of the international order has by specific reference been traced to the retrogression from Western civilization on the part of two revolutionary systems, Nazi Germany and Soviet Russia. Before dealing with a corresponding, though not precisely analogous, disruptive force that has been operative in Western society, it is necessary to etch in that the underlying problem is too pervasive and manifold to be amenable to financial gadgetry by any one country, even if it were possible for any one country to be the vicarious bearer of the burdens of all the rest, in view of the mutual infectiousness and the self-defeatingness of the nihilistic processes toward international rights and obligations that have been let loose by the two major subversive Powers of contemporary history. By way of reinforcement, it is advisable to condense an independently reached similar evaluation from the standpoint of international law of the regressive trends of recent decades, namely, that by H. A. Smith, a former Professor of International Law at the University of London:

> Although no man can anticipate with confidence the future judgments of history, it is permissible to suggest that the deepest significance of the Bolshevik Revolution will in future be found

> . . . in its successful repudiation of the rule of law among the nations. As Grotius pointed out in the final chapter of his great work, in the last resort the authority of the law of nations depends upon the observance of good faith . . . . In direct conflict with all accepted principles the newly formed Bolshevik Government of Russia began its career by repudiating the state debts and promulgated a series of decrees which were wholly irreconcilable with the practices of civilized states . . . . In practice it soon became apparent that no greater sanctity was attached to treaties concluded by the Soviet Government itself . . .
>
> It is important to understand that in substance the attitude of Nazi Germany towards the authority of international law was the same as that of Soviet Russia . . .
>
> The rulers of Russia and of Germany, differing as they did on many things, were agreed in their rejection of this fundamental principle. Each acted upon the theory that the great communities which they controlled were above all law and were entitled to enlarge the area of their power by any means which might be available . . .
>
> . . . Since then the reign of lawlessness has continued and even grows worse . . . . Today the law is not only broken, but also ignored . . .
>
> Finally, the answers to all these questions depend upon [whether] . . . we believe that power is a law unto itself and that there are no rights of a higher order than the will of a sovereign state, or do we believe that all human power, even the mightiest, is unchangeably subject to a higher law.[9]

(4) Just because we tend to become so expert in detecting and extracting beams from the eyes of others without readiness to discern even motes in our own eyes, it behooves us to recognize that within the West there has been proceeding an intellectual-moral erosion of the basis of individual human rights, under which in the last analysis property rights and the functioning of international investment must be subsumed. Our society and the linkage between individual freedom and the system of enterprise and property have been subjected to corrosive attacks, stemming from the adoption by influential elements of the intelligentsia of the Marxist interpretation of history, politics and

[9] H. A. Smith, "The Anarchy of Power", 1 *Cambridge Journal*, 1948, pp. 215-219.

economics. For all the trans-personal character of ideas, they do not " ideate ", so to speak, by themselves, but through individuals. There thus came to be operative through important academicians and publicists, as far back as the prelude to the First World War, a school of thought which applied economic determinism not merely to our political history, but to the motives of the classes and leaders identified with the origination and leadership of our political and economic society. These teachers influenced not only our own academic generation and eventually dominant sections of our middle-class opinion, but also the graduate students from foreign countries, and not least the intelligentsia of Asia that came to absorb the social sciences as preparation for the posts in their countries in the event of liberation from Western imperialist domination. Without attributing any preëminence, this phenomenon can be conveniently viewed through the doctrines and influence of the late Charles A. Beard. By way of historical sidelight, this ex-student of his once ventured to challenge, in class, the theory as having stemmed from a *simpliste* statistical study of the property interests of the Founding Fathers as ground for the *non sequitur* conclusion that they had supported the Constitution not as a way out of the then prevalent chaos in economic and social conditions, but as an instrument of profit. Thus Charles Beard concluded " that our fundamental law was not a product of the abstraction known as the 'whole people,' but of a group of economic interests that must have expected beneficial results from its adoption." [10] The contemporaneous impression of his theories was evaluated, from a conservative standpoint, by the *New York Times* in an editorial in 1917 as follows: " that the Founders of this Republic were a ring of land speculators who bestowed upon this country a body of organic laws drawn up chiefly in the interests of their own pockets." [11] From a radical standpoint, a journalist who was caught in the philo-Russian movement of the period—though disillusioned by the mid-Thirties—described the warm welcome which the leftist intelligentsia accorded to Beard's work and its utilization in their propaganda.[12]

[10] Charles Beard, *An Economic Interpretation of the Constitution* (1913), p. 17.

[11] *New York Times*, October 10, 1917.

[12] Joseph Freeman, *An American Testament* (1936), p. 106.

Without being able to complete the characterization of the various economic-political doctrines that made plausible within the public mind the strictures upon the very economic enterprise system that was responding and adjusting itself to the social needs of the period, it must suffice to refer to the correlative adoption and propagation by the academic and general intelligentsia of the Marxist theory of empire as external exploitation, due to the inadequacy of the internal markets under continued internal exploitation. Instead of empirically observing the differential behavior of the modern-maritime from the classical continental empires, the popularized Marxist versions neglected or distorted the origins and mutations of these Western empires. For, stemming from the opening-up of the New World and the direct transplantation of European nationals, there has been in progress since the criticisms of then contemporary policy by Adam Smith and Burke a rate of improvement—however slow or inadequate the liberals within the very seats of empire have regarded it—in the treatment of the populations, labor for their welfare, and, along with the carrying-out of the cultural mission, a fostering of self-government. All of this prepared the way for that historical anomaly of voluntary abdication of empire and a laying of the groundwork so that the trained intellectuals of those countries would be free to rule their fellow nationals.

The above designated process of the intellectual-moral erosion of the basis of internal and international investment did evoke counter-reactions, which were, however, increasingly regarded as reactionary. Only within this decade have we been vouchsafed a glimpse of the recoil of the late Justice Holmes from the debunking and the denigration of the Founding Fathers, as embodied in the books of Charles A. Beard and Vernon Parrington. Toward the end of the Twenties, Holmes referred, in a letter to Sir Frederick Pollock, to the " rather ignoble though most painstaking investigation [by Beard] of the investments of the leaders," and reaffirmed his conviction " that they wanted to make a nation and invested on the belief that they would make one, not that they wanted a powerful government because they had invested." He then added: " Belittling arguments al-

ways have a force of their own, but you and I believe that high-mindedness is not impossible to man." [13]

The foregoing far from extreme case of the Beard school of history reacting on contemporary conditions has been presented with sidelights in order to show the pervasive influence of ideas that came to be accepted as a sort of intellectual legal tender. Given time and space, the subject would have to include the vogue of intellectual debunking and psychoanalytical rationalizations of the motives of the propertied and management classes. For the decade following the Great Depression, the economic-cultural historian would have to provide a panel for the fascination that was exerted over the intelligentsia by the Soviet claims of having found a simple and costless answer to the business cycle and unemployment—a point of view that with curiously timed irony was represented by the second edition of the book on Soviet Russia by the two Webbs which, notwithstanding the purge that had intervened, presumed to remove the question mark from the words in the title, *A New Civilization.*

To the historical mural would also have to be added a panel devoted to the corollary ideas attributing an inherent stagnation to nonsocialist economies, and proposing that to deal with the imputed chronic underemployment of human and material resources, governmental expenditures could proceed by means of forced reduction, to the very obsolescence, of the interest rate and along lines of indefinite " deficiteering ".

In that context, cognizance would have to be taken of the canonical leadership over this academic-economic generation exercised by the late Lord Keynes who, in his important book of the mid-Thirties, in part reflected these trends, though he also wanted to retain part of the old individualism:

> The authoritarian state systems of today seem to solve the problem of unemployment at the expense of efficiency and freedom. It is certain that the world will not much longer tolerate the unemployment which, apart from brief intervals of excitement, is . . . inevitably associated with present-day capitalistic individualism.[14]

[13] *The Holmes-Pollock Letters,* ed. by M. A. de W. Howe (1941), vol. II, pp. 222-223.

[14] J. M. Keynes, *The General Theory of Employment, Interest, and Money* (1936), p. 381.

As against current tendencies to blur the differences between Keynes and socialists, it is only fair to add that under the impact of the war he came to realize that what he thought was a general theory was only a special case, and that for the war and the immediate post-war conditions of mounting demand " the classical theory comes into its own again from this point onwards." But such was the momentum of his dramatized presentation of his theories, based upon the peculiar situation between the wars, that the Baconian idol of the academic theater that disciples made out of Keynesian theories has led some members of the governmental intelligentsia concerned with the problems of international investment to assume that the obstacles to private international investment can safely be ignored, because the government can step in with loans at rates detached from economic risk considerations, which loans can be allowed to rise to indefinite heights on the assumption that a rising world standard will maintain and augment full employment within the United States at progressively higher levels of mass welfare.

Part II

Dual Discords Between (1a) Attitude of Foreign Governments Toward Old and (1b) Their Tremendous Demand for New Investments, and Between (2a) Our Government's Appeal for and (2b) Administrative Obstruction of Partnership with Foreign Nationals in Technical Industrial Development

The dimensional analysis developed, on the one hand, restrictions and obstructions to the adequacy of scale and freedom of flow of international trade due to the diremptions in the economic fabric between the Western and Eastern continents and within Europe between the Western industrial and the Eastern less industrial halves, and, on the other hand, the restrictions and obstructions that are in part the heritage of the near generational attack on the system of human rights, inclusive of property, by Soviet Russia and then Nazi Germany, and in part the product of the internal cultural corrosion and schism of the Great Western Society itself. Though by a species of historical " jobbing backwards ", current thought has looked at the first post-war period in the shadow of the Great Depression which followed, it is submitted that the Twenties, for all their defects, represented

extensive and rapid reconstruction of world trade, restoration of world currencies and financial stability, and consequential regenerative flow of international investment. The major underlying causes were the continuing potencies, as accepted postulates, of the doctrines of individual rights, liberties and obligations, and the governing norms of the rule of law between individuals within and across national boundaries and between the sovereign states of the Western society of the war-allied and associated Powers and the other members of the then unitary, instead of divisive, League of Nations. The crisis which began with the Great Depression changed from the financial and economic into a fundamental cultural one (as contemporaneously defined by this writer):

> The outstanding feature of this Great Depression is that the economic order and the Great Society since the Renaissance have come to be threatened not by the destructive impact of external or natural forces, but by a disintegration from within . . . . Now the economic order . . . is reverting to the feudalism and the barter which ensued upon the break-up of the Roman Empire . . . while at the same time it remains subject to the impact of the most sensitive and modern of subversive forces incident to a highly developed credit economy.[15]

The economic recovery which followed the Great Depression was partial not only in magnitude but in the failure of a restored world order, and was in turn overtaken by the successive German aggressions and the rehearsal of sectional wars in the Far East and in Europe. The legacy of unreliable currencies, unstable fiscal policies, and capital spoliation by Bolsheviks and Nazis—with faint to frank emulations even among stout enemies of either or both systems—has led to alternate haemophilia and clogging of capital, with scattered hoards belonging to nationals of the very countries needing direct investment and loan capital. The arbitrariness and the oppressiveness that by the moral Gresham's Law have swept over our system and have partially impinged upon internal as well as international investment have thus resulted in an attitude surcharged by Keynesian

[15] From a memorandum toward the end of the depression included as a documentary appendix to C. F. Roos's *N.R.A. Economic Planning* (1937), pp. 520-536.

liquidity preference—an attitude of skepticism toward persistent depreciators of their promise and unabashed devaluators of their word.

1a (1)—While the instances are legion, it is proposed to confine the illustrative treatment to one country from which American liberal public opinion recoils and to another which is held in high esteem by American liberals.

The struggle between the Spanish government and a group of continental investment interests with ramifications in Canada and in Latin America is the first instance. From the time of the Spanish Civil War onward the Spanish government has not permitted foreign exchange transfer of internal earnings for servicing the bonds of the Barcelona Traction Light and Power Company. In a climactic stage of that struggle, reached a year and a half ago, an ironic inversion of normal conduct between individuals and between states occurred. Though the owner of the operating utility is a Canadian holding company, subject to the jurisdiction of the Canadian courts, the Spanish court issued an order in bankruptcy against the Canadian company on the ground that it had defaulted on interest payments—despite the fact that at the time the Spanish subsidiary had more than enough pesetas in cash in banks in Spain to pay off the arrears, but was not allowed to effect transfer to London. The spearhead of the attack is an eminent member of the Camarilla who had acquired large holdings in the London market. In consequence of the declared default, the government, through the dependent courts, ordered the seizure of another operating property of the Canadian holding company, the Ebro Irrigation and Power Company. The Spanish receiver immediately proceeded to appoint a rump board of directors of the subsidiaries against which there were no bankruptcy orders; and the new board immediately appointed new solicitors with instructions not to defend the Company. The displaced management officials of the operating companies applied to the Spanish courts for reinstatement on the ground that there were no legal proceedings against the companies, to which the courts replied that since there were no legal proceedings against them they had no reason to be in court. In keeping with that curious penchant of totalitarian systems for combining exploitation of the freedoms accorded to foreign nationals within the democracies and façades of formal-

istic legality, the entering wedge in the proposed conquest of the Company was the purchase by a Spanish national, an intimate of the Caudillo, on the London market of the very bonds that had undergone depreciation since 1936, because of nonpayment of interest; and thus by 1948 he had become the largest holder of sterling bonds. So the former British holders have no interest, and, according to British financial sources, the Treasury point of view is that if the Spaniards ultimately provide sterling to pay off in full residual English holders, justice will have been preserved. It would also appear that the Spaniards, cognizant of the British need for industrial raw materials for import into the United Kingdom and outlets for British exports, have been pressing the consideration that it is better in the British interest to let the Spaniards use their current earnings of sterling to buy British goods, instead of servicing bonds that have already been acquired by a Spanish national who personally can get along without it. The underlying shareholders who originated the venture and sustained it through the trials of the Civil War are mainly Belgian. On the facts open to a student of current international developments, without any special interest in the matter, it seems clear that this well-recognized technical and financial holding company has performed notable service in Europe and on this Continent. Finally, to the diplomatic protests that have been made by the Canadian, Belgian, and American governments, the Spanish reply has been that this matter is in the courts *sub judice* and hence it involves the sovereignty of Spain.

Thus we have in miniature the breakdown of the rule of law and of the dependence of international investment upon recognition and effectuation of rights as inherent in the individual and involving rational procedures and equitable adjudication. What emerges in sharpest relief is that the functioning of international trade and investment depends upon an independent judiciary. For where the judiciary, as in totalitarian countries, is an appendage of executive policies and ambitions, foreign capital is subjected to arbitrary political action and every form of blackmail. While the instant case etches in the problem sharply, it betokens a trend that has spilled over from totalitarian to other countries. Indeed, by a curious irony, the West, after responding to the humane pressures from within for abandoning the "capitulations" system, that it had established earlier in

undeveloped countries for the protection of Western traders and investors, has latterly become subjected to " capitulations in reverse ", to making the foreign investor an economic " displaced person ".

1a (2)—Having throughout sought to see the principles behind the contentious passing scene, out of concern for the problems of economics and well-being of the developed and the underdeveloped countries, we feel that no umbrage should be taken at the ensuing broader and deeper analysis of the handicaps to private enterprise in India, and for that matter also to adequate translation by American governmental agencies of the sympathies felt for India. While some of us could not share the equanimity with which the pacifist attitude was translated by the Prime Minister into " impartiality " toward the vital struggle between the two super-Powers, the purely economic aspects of capital attraction have not been changed by the mere repetition of the promise made last April that old and new foreign investments would be free of restrictions and conditions that did not equally apply to Indian enterprise, all the more so as it was coupled with the qualification that the state of the exchange market might impair even that assurance. The trailing cloud of the spell that Soviet Russia had exercised in the Twenties on leading Far Eastern figures is manifest in the recurrent assumption, underlying some Indian utterances, that the underdeveloped continent can raise itself by its economic bootstraps, by providing a temporary hospitality for foreign investments that would later be nationalized.

The inflation of the price level which has far outdistanced that of the English-speaking world has come to be coupled with a burden of taxation of sudden steepness. From such accounts as have come through, this taxation is administered in a discriminatory way against foreign investors. Commenting on the plea by the Indian industrialist, Mr. G. D. Birla, for foreign capital investment in his country, a letter to the *London Times* recently drew attention to the fact that, on the one hand, the treatment of nonresidents in India is much more severe than in pre-war Britain, and, on the other hand, nonresident investors are subjected to specially adverse treatment. The details cited included the following: (1) the nonresident individual is charged to Indian income tax and supertax at the rate based upon his world

income and not alone his Indian income; and (2) nonresident private companies are charged to Indian income tax at the maximum rate and also with Indian company supertax. While claims may be filed for remedying the incidence of double taxation on British residents, it is thought that many years would have to elapse before full relief would be obtained in the eventual rupees.[16]

In a deliberately cautious note on "Private Enterprise in India", by the Executive Vice President of the Far Eastern American Council, the criticism of the taxation system for foreigners is coupled with an imputed fear of possible nationalization, capital levies, or forced loans. The requirement of law and order mentioned earlier as a fundamental postulate is repeated in the form of general propositions about "peace and domestic stability", supplemented by "civil liberties and the basic individual freedoms." The moral drawn from the Spanish case of the indispensability of an independent judiciary is also repeated: "An adequate and competent system of law should guide an independent and incorruptible judiciary." What is called a brief catalogue of prerequisite policies is rounded out by the following comprehensive proposition: "Management must be free of restrictions unduly limiting its use of trained foreign personnel, and free of restrictions on the application of modern technology; taxation, price controls, and other rules of commerce and trade, including labor legislation, should be applied equitably and without graft, designed to encourage and preserve competition and the free market." [17]

* * *

1b—As to projected magnitudes of foreign investment, the Food and Agriculture Organization of the United Nations recently ventured to bring together what is available in the form of national plans, and estimated the size of the necessary expansion on a world scale. As the plans cover periods from two to ten years, the statistical staff adjusted them to a uniform four-year length and thus arrived at the tentative estimate of the

[16] Letter of K. M. Parry, *London Times*, October 23, 1949.

[17] "Private Enterprise in India", M. Hughes, Executive Vice President, Far Eastern American Council of Commerce and Industry, *Fortune*, December 1949.

global foreign investment needs for the next four years. For the Far East, dominated by India, the figure was just short of $11 billion, or a quarter more than the $8½ billion for Latin America. By a leap of optimism as to the magnitude of internal savings, it assumed that only about half would have to be financed externally.

An Indian authority, Professor D. Ghosh, has worked out a scheme for ten years, aggregating twenty thousand crores.[18] (A crore equals ten million rupees. While the rupee is currently valued at twenty-one cents, the devaluation that has taken place since the estimate leaves open the question as to whether Professor Ghosh would not raise it by a large fraction to take care of the advance in foreign imports.) The earlier estimates included in the Bombay Plan for doubling the submerged standard of living in India in fifteen years, when converted to the current level of prices, would be over thirty thousand crores, and thus on a decennial basis is on a parity with Professor Ghosh's estimate.

As to internal savings, an estimate contained in the quarterly publication issued by the Tata Industries of Bombay comes out to three hundred crores in the first post-war year. Lest the penchant for what Justice Holmes called "fallacies of delusive exactness" tempt the statistician to raise that figure by the subsequent marked inflation of the price level in India, another statement in the same publication draws attention to the constriction of internal capital formation from the advances in taxation that the new government has made. Incidentally, the carrying on by the new government of military outlays that form a higher percentage of the budget than in Western countries, as a result of a state of war suspense over Kashmir by a professedly pacifist government, has, since the writing of the article, further dislocated the fiscal condition of India and brought in train the imposition of additional indirect taxes on essential commodities. One can all the more readily endorse the opinion of the article that "the optimistic view regarding the capital resources of India which has been taken by the National Planning Committee and the Advisory Planning Board has, therefore, no basis in facts."[19]

18 *Pressure of Population and Economic Efficiency in India* (1948), p. 94.

19 "Foreign Capital—Higher Standard of Living", *Tata Quarterly*, vol. IV, No. 2, April 1949.

2b—Leaving for a later discussion the assembled material on the magnitudes of estimated needs by foreign countries and the correlative American programs and estimates, especially in connection with the Point Four task, it is essential to draw attention to the divergence of policies within our government between agencies pursuing an extension of anti-trust repression in the foreign field and those pleading for investment expansion. The bewilderment of the public as to the common sense of recent anti-trust cases has extended to the academic profession from the standpoint of the economic rationale. The projection of the Point Four program throws into relief the manifest contradiction between the Antitrust Department's doctrinaire attack on international collaboration in concert of interest for American and foreign technical corporations and the fostering solicitude of the State Department and the Administration for the enormous extension of American direct investments.

The initial reference to the absorption of bewilderment by the current generation, under the impact of disturbing developments, is echoed in a contribution by the Dean of the Harvard School of Public Administration on " The Current Status of the Monopoly Problem in the United States ".[20] Early in this article he queries the considerations that have influenced the Courts in their decision on anti-trust action and contrasts the economic preference for empirical behavior and effective business performance over the legalistic adherence to a type of laissez-faire free competition that has come to be recognized by economists as an unrealistic abstraction. Accordingly, in commenting on a recent major anti-trust decision, Professor Edward Mason says: "Although this decision probably broke new legal ground, it is from an economist's point of view marred by what is at best some very dubious economics." In further reference to that case and industry he later observes that " the leading economic authority found the behavior [of the Company] to lead in exactly the opposite direction. But even if the Court is correct, it would appear to be extremely difficult to distinguish between a progressive embracing ' of each new opportunity ' and what would ordinarily be considered desirable competitive perform-

[20] 62 *Harvard Law Review*, pp. 1265-1285, at 1271, 1273, 1275, 1284-1285 (June 1949).

ance." Toward the end of the article there is an implicit challenge to the recent type of anti-trust crusade: "There has, in my opinion, been too much preoccupation in the enforcement agencies with the question what case can be won, and too little with the question of what difference it makes .... At this point the alternative objectives of anti-trust policy and how they should be related to each other, which have been the subject of this paper, can no longer be avoided."

In connection with the corresponding dichotomy in international corporate activities between the Justice Department's repression and the State Department's stimulation, any essayed exposition labors under the disadvantage that the opposition to monopoly sets off, by the mere invocation of the shibboleths, harmonic resonances that predispose the reader to follow through technical discussion, whereas anything that looks like a challenge conjures up words and institutions with negative emotive meanings. Yet without attempting to emulate Professor Mason in his leisurely review and comment on salient cases, the international investment implications and the issues of public policy are an indispensable and integral part of not merely the formulation but also the effectuation of any international investment policy. Speaking broadly, in a era in which international trade abroad has come to be controlled by governments—and our own organs of government have had to adjust themselves to that trend in their recent conferences and negotiations—the newly embarked campaign by the Department of Justice enforcement officials to dirempt the fabric of international technical interchange and to destroy intercompany agreements, lest these minor foreign subsidiaries of American companies serve as monopolistic restraint on the total volume of export-import trade of the United States—such an attitude is tilting at windmills. Most of these market agreements have served primarily to protect foreign companies against a type of American competition within their markets that would have swept everything before it. Whether or no the foreign affiliate would be ready to operate without agreement by the American company not to interfere within its domestic or traditional market, the present governments of the West and the East are too dominated by economic nationalism and their preference for socialist experiment to permit a corporate national of theirs to acquiesce, even on paper,

in the transcription of outmoded textbook theories of competition with which officials of the Department of Justice have latterly become so enamored. By accepting the European practice the advantage gained by the American company is that it could thereby, backed by its direct investment, secure a permanent position in a foreign market. Moreover, if the officials of the Justice Department permitted themselves to be brought even in tangential contact with the transformed world economics of bilateralism and quotas, they would soon learn that direct export trade competition cannot secure for American enterprise such a permanent position.

The scarcity and the strain on the dollar exchange position of the foreign countries mean further that the British, for example, would not allow foreign exchange to be wasted on imports from the United States—to use commodities in recent cases, of tapered roller bearings or titanium pigments—if there is any extant or evocable capacity in the United Kingdom, regardless of how favorable is the price margin of any American competitor on a pure trading basis. If there is not such capacity, they will try to buy it from soft-currency sources.

To an economist attuned to international developments the disintegration solutions being pressed by the Department of Justice, and in some cases consequentially effected, represent an unconscious sabotage of far-reaching scope for the whole international economic program. With isolationist zeal the alternative is presented to American technical companies of either acquiring wholly the foreign subsidiary or being wholly acquired. As an economist with technological interest, mindful of the tremendous contributions made after the First World War, say, to our oil and automobile industries by the European-developed techniques of geophysics and aware of continuing significant scientific developments, especially in Great Britain, this writer holds that it is collaboration and symbiosis of economic development that should be systematically fostered for the fructification of the joint technologies, let alone the dollar earnings to be provided to Britain and to other countries. While the economic potential of such collaboration cannot be properly estimated before its eventuation in specific areas, this economist, in connection with a preview of the British crisis of 1947, did venture to indicate the plasticity of the British situation by

applying the income productivity to pre-war Germany of pharmaceutical patented processes to what might have happened if Britain's primacy in penicillin as discovery had continued in conjunction with American enterprise through its diffused mass-market applications. Britain, as pioneer in penicillin and the sulfa drugs, has in this current year also developed the pain-killing drug heptalgin which is regarded as six times more effective than morphine. It has also produced a new drug which will protect cattle in Africa from the dread tstese fly and may thus open up new meat protein food areas to Africa and Asia. Impressive pioneer work is also illustrated in the development of an industrial general-purpose gas turbine. In a word, for all of the grave difficulties of the post-war period, practical intellectual creativity is still available for translation into reality by technical and investment coöperation between British and American economic interests.

PART III

Foreshortened Recall to the Rationale of a Progressive Investment Order

At this crucial phase in the unresolved enterprise of world recovery, the leadership that history has thrust upon the New World itself needs the revival of sources of initiative and substance that have been rendered dormant by unsound ideas and policies. " Next to the discovery of the New World," observed Lord Acton, " the recovery of the ancient world . . . marks the transition to modern life." Similarly it is recovery of old truths about and tested codes of conduct for and toward individuals and nations in their economic relationships that will enable the New World to redress the shattered balance of the Old.

Since the subversion of the rights of investors has been an international phenomenon and part of the eclipse of the rights of individuals, we, too, need to recapture the fundamental concepts of natural rights. In this connection it is worth recalling that the classic phrase of the Declaration of Independence about the pursuit of happiness is an ellipsis for the full statement in the Virginia Bill of Rights, adopted June 12, 1776, to wit:

"The enjoyment of life and liberty, with the means of acquiring and possessing property, and pursuing and obtaining happiness and safety."

Our early history provides a crucial illustration of the immediate decisiveness and the very long-run fruitfulness of restored bases of investment. The incident of Shays' Rebellion involved a challenge to independent judiciary in adjudication of claims. That issue of law and order prompted the Founding Fathers to release the succession of steps that transformed the Confederation into the constitutional Union. And an early act of the new government was the Hamiltonian settlement of foreign and domestic debts that had been incurred by the aspirant to nationhood, a settlement that in very deed became the "adequate support of public credit".

In view of the remarkable progress made by our society in at once extending the rights of individual property, as obliquely in the latest pension programs, and in liberalizing by corporations of their operations for broader and longer-term economic and social progress, it is deemed most urgent that we recapture the sound and constructive orientation that was formulated by Justice Holmes at the very time of the opening propagation of the misinterpretations of our system that have proved so disruptive:

> We are apt to think of ownership as a terminus, not as a gateway, and not to realize that except for the tax levied for personal consumption large ownership means investment, and investment means the direction of labor towards the production of the greatest returns . . . . We need to think things instead of words . . . . When we do, it is obvious . . . that the great body of property is socially administered now, and that the function of private ownership is to divine in advance the equilibrium of social desires—which socialism equally would have to divine, but which, under the illusion of self-seeking, is more poignantly and shrewdly foreseen.[21]

[21] *The Mind and Faith of Justice Holmes*, the essay on "Law and the Court" (speech at dinner of Harvard Law School Association of New York, February 15, 1913)—ed. by Max Lerner (Boston, 1943), p. 389.

Remarks

Chairman Bidwell: Thank you, Dr. Sachs.

So, we have been considering the matter of foreign aid. I think I am accurate in saying that so far it has been almost strictly an economic program. Those of you who have followed this development in foreign policy know that the plan proposed by Secretary Marshall in his speech at Harvard University was largely an economic program, but as events proceeded it became evident that an important feature of our aid to Europe was going to be military aid.

It is probably not accurate to say that our next speaker, Major General Lemnitzer, was the father of the Military Aid Program, but, as I reviewed his connection with it, I thought we might call him its big brother. He first came to public attention in this phase of his career when he was made head of the group of United States observers to the Conference of the Five Foreign Ministers of the Brussels Union in the summer of 1948.

Our participation was gradual, as he will probably explain. The interest of the United States in military coöperation in Europe was very evident, but just what part we would take was not entirely clear to begin with; so that, as happens in many conferences in which we are interested, we began by being "observers". This is a rather vague designation. General Lemnitzer once remarked that he was not quite sure whether we were nonparticipating members of the group or participating nonmembers. Perhaps he will tell us in his remarks which we were.

I am not going to trespass on his time to recount to you the brilliant career he has had as an officer, particularly in staff work. His record shows a number of very extraordinary exploits. He was in deputy command in General Clark's submarine expedition to North Africa, later deputy chief of staff under Marshal Alexander in Sicily and Italy. He is well prepared to talk on this subject, and I am sure we shall all listen to him with attention.

General Lemnitzer: Before getting into my subject, I want to say that I welcome this opportunity to talk to the Academy of Political Science. Having recently completed a tour of duty at the National War College, I want to take this opportunity to express to the

Academy our very sincere and deep appreciation for all the assistance that the Academy has given the College in the early years of its existence. This assistance, in the form of lecturers, advice and guidance in preparing our curriculum, has been invaluable. I hope that this close association will continue indefinitely.

I am glad to be able to tell you about the Military Assistance Program because, with the representation present here today, it provides an unparalleled opportunity to give you information on the background thinking which was involved in the preparation and in the objectives which we seek to achieve in the Program. I hope that you will then be in a better position to discuss it with your associates when you return to your respective duties.

THE FOREIGN MILITARY AID PROGRAM

MAJOR GENERAL LYMAN L. LEMNITZER
U. S. Army, Office of Secretary of Defense

THE American Foreign Military Assistance Program authorized by the Mutual Defense Assistance Act of 1949 which was passed by the 81st Congress and signed by the President on October 6, 1949 provides a vital and specific means of augmenting the collective military strength of free nations friendly to the United States and thus furthers the security interests of the United States itself. This important step to strengthen our security is a part of the pattern of United States post-war policy which includes the Rio Pact, United States support of the Brussels Pact Powers as indicated by the President in his speech of March 17, 1948, and the ratification by the Congress of the North Atlantic Treaty.

In brief, the Military Assistance Program under the Mutual Defense Assistance Act of 1949 provides:

a. For all United States foreign military aid projects being brought together in a single program.

b. An appropriation of $1.314 billion to cover the entire United States foreign military aid for the FY 1950. This sum is distributed as follows:

North Atlantic Treaty nations of Western Europe	$1,000,000,000
Greece and Turkey	211,370,000
Iran, the Republic of Korea and the Republic of the Philippines	27,640,000

and the sum of $75,000,000 as an emergency fund which the President may expend in the general area of China to carry out the policies and purposes declared in the Act.

The Military Assistance Program complements the North Atlantic Treaty and continues United States military aid to certain other countries which have been receiving this type of aid from us for several years.

I would like to emphasize the fact that this Program is not something that the United States is obligated to do. We are doing it partially to help our friends and also to strengthen our own security. This Program has been based on the urgent request of the nations involved. The primary objectives are to strengthen the defensive military capabilities of nations friendly to the United States in order that they may improve their ability to resist external aggression. The initial part of the Program has another objective, namely, to strengthen the internal security of these nations.

Long strides have been made in recent years in the economic recovery of many of the nations concerned. However, there has grown in many of them a fear of aggression which has been an important factor in retarding the full swing into the subsequent stages of economic recovery. In its initial stage the Marshall Plan has achieved great success. Order has replaced to a considerable degree the economic chaos left in the wake of World War II. Production has increased; more food and housing are available; and in the many activities which are the gauge of a nation's economic life, there is an ever-increasing tempo.

In the complete recovery of these nations, initiative and self-confidence are vitally important. Both, however, are retarded by fear and insecurity which if left unchecked may well paralyze the recovery effort and destroy the psychological basis upon which recovery so much depends. People are reluctant to make strenuous effort and personal sacrifice required for complete economic recovery when they fear that their homelands may be easily overrun by alien armies and the fruits of their toil taken from them. They are reluctant to invest their savings in local businesses, and capital will not flow in from outside sources. Therefore, if recovery is to continue to progress, a sense of security must be restored. I firmly believe that military stability and security are indispensable factors in attaining real economic and political stability.

Lest there be any fear that the carrying out of the Military Assistance Program is likely to jeopardize our economic recovery objectives in the countries concerned, let me assure you that one of the basic principles which governed preparation of this Program has been that economic recovery shall not be en-

dangered thereby. The preparation of the Program has been a joint enterprise which has been participated in by the Departments of State and Defense and by the Economic Cooperation Administration. We believe that in the preparation of this Program we have been able to strike a very satisfactory balance between the United States objectives in the foreign-policy, economic-recovery, and military fields.

Under the Program three general types of aid are proposed as follows:

a. The direct shipment of carefully selected end-items of military arms and equipment,

b. Aid to the recipient nations in increasing their own production of military equipment, and

c. Technical and training assistance to help the nations concerned to receive, maintain and employ the many complex types of equipment involved.

The largest part of the Program provides for the shipment of capital items of military arms and equipment to fill the urgent needs of the existing Armed Forces of the recipient countries. A portion of this equipment will be supplied from stocks which happen to be excess to the present needs of the United States Armed Forces. Under the legislation the worth of excess equipment and materials which may be furnished under the Program cannot exceed $450,000,000. By " worth " is meant the gross acquisition cost to the United States when this equipment was originally procured.

This equipment is in our stocks at the present time. It has been paid for by the United States government, and the only charge which will be made against the Program for this considerable amount of equipment will be the cost to take it out of storage, reactivate and rehabilitate it, and ship it. That is the only cost which will be charged against the $1.3 billion appropriated by the Congress for equipment in this category.

Another portion of the equipment will come from United States reserve stocks. The levels of these reserves are determined by the requirements of United States Armed Forces under existing plans. Equipment taken from these reserves must necessarily be replaced; otherwise our reserves would be depleted below safe levels. Some of the required equipment is not available in

either of the foregoing categories and must, therefore, come from new production.

A considerable amount, indeed over 90 per cent, of the funds appropriated in the Mutual Defense Assistance Act will be used to pay American labor to rehabilitate equipment coming from our excess or reserve stocks or will go to American industry for the production of the new equipment required for direct shipment overseas or to replace items that have been taken from our own stocks.

An important aspect of the Program is the provision of technical and training assistance. Military and civilian technicians will be needed to assist recipient nations to receive and assemble the equipment, and to instruct them in its maintenance and employment.

Another important provision of the Act authorizes the President from time to time, in the interest of achieving standardization of military equipment, to provide military assistance, on a reimbursable basis and without cost to the United States, to any nation which has joined with the United States in a collective defense and regional arrangement; for example, the Rio Pact and the North Atlantic Treaty.

At first glance, this may not seem to be an important item, but many nations already have considerable stocks of American equipment. They need maintenance and spare parts. They are unable to buy them on the American market, and the assistance of United States procurement facilities to obtain this necessary aid will be of great value to them.

Many varied and complex problems of standardization are raised by this Program and the North Atlantic Treaty. Complete standardization is difficult, if not impossible, ever to achieve. The two principal enemies of complete standardization are progress and cost. As new weapons and equipment are developed, disposal or use to be made of existing equipment becomes a major problem. When a new weapon or item of equipment is adopted, nations are faced with the alternative either of discarding the older equipment altogether and equipping all of their forces with the newly developed item or of making the best possible use of equipment already on hand. It is obvious that if the former course was adopted huge amounts of very useful and valuable equipment would be discarded, a procedure

which no nation, however wealthy, could possibly afford. We are, therefore, always faced with the problem of how to make the best possible use of equipment on hand and at the same time continue the development of improved models with which to equip our forces as funds are made available.

There are, however, certain areas of standardization in which great progress can and should be made in the North Atlantic Treaty organization. These are in the fields of standardizing organization, procedures, techniques of operation and training. As a result of developments in World War II and the progress made in the post-war period the United States can make a major contribution by lending its assistance to those nations which are only now beginning the rehabilitation of their military establishments by providing advice and guidance in these, and other similar, fields.

One important feature of the Military Assistance legislation which applies to the funds appropriated for the North Atlantic Treaty nations is that $900,000,000 of the one billion appropriated for those nations will not become available until the President of the United States approves recommendations for an integrated defense of the North Atlantic area which may be made by the North Atlantic Council and Defense Committee.

The principle involved here is that after $100,000,000 is spent for "emergency assistance", integration of defense planning must precede further assistance. The Congress considered that the contribution of United States military resources to an integrated defense was a prudent investment, but that contribution of these resources to uncoördinated national establishments would be no investment at all but merely a futile expenditure.

By this provision of the legislation Congress has made it clear that it is unwilling to support an array of separate and unrelated armed forces among which there is no unity of purpose, unity of defense planning, unity of direction and unity of execution.

The Congress was aware that a completely detailed and unified defense plan among so many nations was a long-term process which would require many months to prepare. It had no intention to delay the carrying out of the Program until plans were worked out to the last detail. Congress did, how-

ever, intend that, before the major portion of the aid became available, there be general agreement from the outset on the principle of unity of defense.

The Congress felt that each nation must agree to do its part, as determined by its position and its resources, in relation to the common security of all. No one nation in the group must aspire to perpetuate or expand its various components for purely national considerations. Each will have to recognize its obligation to balance its forces in relation to the needs of the whole area. For some this may require submission to a secondary status in certain types of armament. For some it may require specialization in military activities that would not be preferred if free choice were made on a purely national basis. All must be willing to give up preferences which are not in keeping with the common defense. Needless to say the North Atlantic Treaty organizations are working toward the development of an integrated defense at the earliest possible date.

Effective administration and implementation of the Military Assistance Program require its coördination with our political, economic and military policies. The President has decided that primary responsibility for the direction of the Program will be exercised by the President through the Department of State. In carrying out this assignment the Department of State will work closely and continually with the Department of Defense and the Economic Cooperation Administration as the two additional governmental agencies most directly concerned with the Program. The Department of Defense has a major rôle in the implementation of the Program. It will be responsible for the task of rehabilitating and reactivating equipment taken from our reserve stocks and for the procurement of new equipment. It will also be called upon to provide qualified civilian and uniformed personnel to assist in the technical and training fields.

The broad policy guidance for the Military Assistance Program will be exercised by the Foreign Military Assistance Steering Committee comprising the Secretary of State as Chairman, the Secretary of Defense and the Administrator of Economic Cooperation as members. Coördination of the Program within the Executive Branch of the government will be effected by an advisory interdepartmental committee known as the Foreign Military Assistance Coordinating Committee. Both of

these Committees have been in existence for some time and it was under their guidance that the programs were prepared and presented to the Congress. Responsibility for the direction of the operations of the Program will be exercised by a Director who is also a Special Assistant to the Secretary of State.

Finally, under the Mutual Defense Assistance Act of 1949 the United States has taken a long and positive step toward strengthening the military capabilities of many nations friendly to us and which, under present conditions, are unable to do the entire job without our assistance. The problem involved can be stated in relatively simple terms but the implementation is extremely complex. The undertaking will tax our political, economic and military skill and wisdom to the limit. Our friends for their part will have to demonstrate that they are using our aid effectively and are doing everything possible to help themselves. These problems, while great, are not insurmountable. We have faced greater ones in the past and have solved them successfully. I firmly believe that we can carry out this Program successfully and in so doing we will strengthen not only the security of the nations receiving aid but also the security of the United States.

Remarks by the Chairman

Chairman Bidwell: We are grateful to General Lemnitzer for his enlightening discourse.

I now declare this session closed with thanks to all of the speakers this afternoon.

PART III

THE FOREIGN AID PROGRAM AND THE NATIONAL INTERESTS OF THE UNITED STATES

INTRODUCTION *

THOMAS S. LAMONT, *Presiding*
Vice-President, J. P. Morgan and Co. Incorporated
Trustee, Academy of Political Science

THIS is the Autumn Meeting in the sixty-ninth year of the life of the Academy. I see some new faces before me tonight, and I think that it may be useful to explain what the Academy is.

As a neophyte trustee a few months ago, I naturally scanned the faces of my fellow-trustees at my first board meeting. They turned out to be members of the Columbia faculty and business men. It was soon apparent that this was another organization in which Wall Street dances to the tune of Morningside Heights! That is the reason I have the honor and privilege of being here this evening.

As to the Academy, for those who can read, it has published the *Political Science Quarterly*, ever since 1886, an excellent journal of opinion edited by the Columbia faculty. For those who eat, the Academy has these semi-annual meetings. They provide an independent forum. The Academy does not advocate or sponsor views or causes. It leaves those functions to its guest speakers. By them and through them it seeks to espouse the cause of free inquiry, to cultivate fruitful discussion and

* Opening remarks at the Dinner Session of the Annual Meeting.

even controversy, to engender opinion-making fermentation among all who think on the great issues of the day.

We are proud of our Academy, and we are always glad to have more members who, besides the pittance for dues, need only have the qualifications that they can read and eat.

We are particularly proud of our President, Lewis Douglas, who is at his post abroad tonight. He sent me a cable message today which I shall read to you:

> I wish I could be present to join members of the Academy in welcoming Paul Hoffman and George Kennan. Will you express to these distinguished guests my thanks for their presence and my regrets at my absence and to the members of the Academy my congratulations upon the evening ahead of them.
>
> Lew Douglas.

(Applause)

Lew Douglas has been a great American Ambassador to the Court of St. James's, but beyond his duties as our representative in Great Britain, our government, recognizing his capacities, has kept him constantly engaged in important councils and negotiations on the great European problems in which we have a vital interest. Lew Douglas, I know, has been of extraordinary assistance to our two distinguished guests of this evening. In word and deed he has always loyally supported their policies.

At the time of our last meeting, the Academy's Director, Grayson Kirk, was Professor of International Relations at Columbia University. He is even more than that now and we are even prouder of him. He is now Provost Kirk, the Provost of Columbia University. He was appointed to that important post by the President of the University six weeks ago. No one can gainsay that General Eisenhower picks able chiefs of staff. He has done it again. (Applause)

Most of you have seen the program of our morning and afternoon sessions. Many of you attended and were stimulated by the suggestive addresses covering various phases of the Foreign Aid Program, E.R.P., military aid, and their effects upon our economy and Europe's economy. We are grateful to our various friends from Washington and our friends from the universities and the Council on Foreign Relations who joined with us and

led the discussions and contributed so importantly to making the meetings successful.

As we pay honor tonight to the two speakers who are leaders in carrying out and planning our foreign policies, let us not forget another great leader, twice our guest in recent years, whose foresight resulted in placing upon our guests of this evening the heavy responsibilities they so ably carry. It was in April 1947 that General Marshall established the policy-planning staff of the State Department and appointed George Kennan its Director. Two months later, in June, General Marshall in his notable speech at Harvard Commencement outlined the broad policies which developed into E.R.P., administered by Paul Hoffman's E.C.A.

In a cold war, the military forces are a very important defensive factor, but offense is what wins wars; and in this cold war, the offense must be sustained upon the economic and political fronts.

Mr. Hoffman and Mr. Kennan are two of our leading generals on those fronts; but these two generals, while waging their battle, are not responsible to any one directive authority such as the Joint Chiefs of Staff—nothing so simple as that. These generals must plan their acts and act subject to political pressures—public opinion, congressional opinion, congressional committees, tariff commissions, shipping boards, limited budgets, and what not else. More than generals in hot wars, perhaps even more than business men in this American economy of ours, the actions of our guests tonight are constantly circumscribed, checked and minutely scrutinized. Theirs must be the patience of Job!

I am sure that Mr. Hoffman and Mr. Kennan are friends and amiable collaborators. The State Department and E.C.A. may have had their disagreements for aught I know; but, thank God, in this realm of government the present leaders are unbound by narrow tradition, with minds open to new means and methods, with a strong sense of decent discipline that does not permit of public invective and questioning the motives of one another.

I believe that these men are slowly winning their war for peace, but their burdens are very heavy. We are deeply grate-

ful to them for joining with us tonight to give us their views on " The Foreign Aid Program and the National Interests of the United States ".

George Kennan, our first speaker, is said to be Mr. X. Mr. X, you will recall, was the author of that notable article on the sources of Soviet conduct which appeared some months ago in *Foreign Affairs.* The article, which seems to have been written by someone who knew his Russia (almost as well as Mr. Kennan!), contains a penetrating analysis of Russia's motives and a wise guide to the course which our country should pursue vis-à-vis the Soviet Union. That suggested course, despite all the difficulties and frustrations and exasperations and temptations which Russia puts in the way of those who would be her friends, has by and large been followed by our own American diplomats.

George Kennan has risen from the bottom right up through the ranks of the Foreign Service. The countries of Central and Eastern Europe have been his special fields, and he has mastered their difficult languages. Then, too, he sent his children to a Soviet school in Moscow, and, like the rest of us fathers who help with the homework, he must have learned something! Indeed, beyond the mastery of their languages, he has through personal experience and intensive study gained a wide knowledge of the Slavic peoples and of their histories. He has a deep understanding of the Russian people.

Many of us in America are so absorbed by the rapid succession of hourly preoccupations that we cease to think. How fortunate is the man whose primary function is to think, to weigh the gravest questions on their merit, to bring his conclusions to bear in the shaping of public policy. Doubly fortunate are we to have some public servants, with rare intellectual gifts, so strategically placed that they can give the utmost in useful service to our country. Such a person is George Kennan, a wise man with the open mind and rich store of patience that his job demands. The Counselor of the State Department and Director of its Policy Planning Staff, Mr. George Kennan.

(Applause)

MR. GEORGE F. KENNAN: Mr. Chairman, Members and Friends of the Academy of Political Science: The Chairman's remark, that the only qualification for participation in the Academy is the ability to read and to eat, reminds me of the statement of one of my colleagues in the Foreign Service. He said that all one really had to do in order to get to the top of the Service was to be sure to shave every morning and come to the office. I think there may be some truth in that because, looking back on twenty-three years of it, I do not recall failing to do that, except one morning—and then I only forgot to shave one half of my face. (Laughter)

FOREIGN AID IN THE FRAMEWORK OF NATIONAL POLICY

GEORGE F. KENNAN
Counselor and Director of the Policy Planning Staff,
Department of State

OUR subject of discussion this evening is the function of foreign aid within the framework of our national policy.

It is not easy to find a useful angle from which to approach a question so tremendous and so complex in its implications as this. When we get such problems of approach, I often like to find out, if possible, how things would have appeared to the early statesmen of this Republic and where we have come from, since that time, in the development of our foreign policy. I would suggest that we use this method of approach tonight.

The first architects of United States foreign policy were extremely wary of any engagement of this country in the affairs of other nations, even along the lines of support to other nations in causes which themselves appeared entirely worthy in American eyes. John Quincy Adams, in an address delivered on the Fourth of July in 1821, pointed out that

> . . . America . . . has abstained from interference in the concerns of others, even when the conflict has been for principles to which she clings, as to the last vital drop that visits the heart. She has seen that probably for centuries to come, all the contests of that Aceldama, the European world, will be contests of inveterate power, and emerging right. Wherever the standard of freedom and independence has been or shall be unfurled, there will her heart, her benedictions, and her prayers be. But she goes not abroad in search of monsters to destroy. She is the well-wisher to the freedom and independence of all. She is the champion and vindicator only of her own. She will recommend the general cause by the countenance of her voice, and the benignant sympathy of her example. She well knows that by once enlisting under other banners than her own, were they even the banners of foreign independence, she would involve herself be-

> yond the power of extrication, in all the wars of interest and intrigue, of individual avarice, envy, and ambition, which assume the colors and usurp the standard of freedom. The fundamental maxims of her policy would insensibly change from *liberty* to *force* . . . . She might become the dictatress of the world. She would be no longer the ruler of her own spirit . . . .[1]

It is true that very soon thereafter Adams was obliged to agree to a certain modification of this view, and that modification was expressed in the message to Congress which has become known as the Monroe Doctrine. He was obliged, in other words, to place a geographic qualification on what he believed to be a valid principle of foreign policy. But I am sure that the qualification, in his mind, did not invalidate the principle.

How valid is Adams' principle today? My own answer would be that while the change in our world situation over the past century has certainly created further qualifications on what Adams stated at that time, these qualifications, like the Monroe Doctrine, are relative; and that there remains great wisdom in Adams' words—a wisdom which we would do well to bear in mind when we would otherwise have trouble coming up with satisfactory answers.

We can no longer afford, to the extent Adams could, to consider that abstention from intervention in the affairs of others is identical with an absence of responsibility. It is hard for the strong to avoid being the responsible. Our bigness and our economic might have taken us past that happy age of innocence in which we could say of the world around us: "We just work here." We have grown so much that we are today like an awkward young giant in a crowded and cluttered room: whatever we do or do not do—whatever position we place ourselves in—we cannot help affecting others.

Furthermore, we have today, from the standpoint of our national interest, a more sharply and significantly divided world than Adams had. Part of it is at least tolerant of the pursuit by us of our national ideals, even though its purposes and philosophies may often vary from our own. Another part views the progress of our national life, as it has been proceeding thus far, with unfeigned and unconcealed abhorrence.

[1] *Niles' Weekly Register*, from March to September 1821, vol. XX, or vol. VIII—New Series, Baltimore, p. 331.

It would be dangerous to underestimate the depth and importance of this rejection of our civilization by the rulers of a great part of the world. If this were only for reasons of theoretical doctrine, we might hope that it could be overcome by reason and persuasion. Unfortunately, it seems to rest also on the hard fact that our abundance and prosperity constitute, for the part of the world to which I am referring, an incontrovertible and intolerable basis of comparison.

In the 1830's the great French traveller, the Marquis de Custine, observed:

> . . . The more I see of Russia, the more I understand why the the Emperor forbids Russians to travel abroad, and makes his own country difficult for foreigners to visit. The political régime in Russia would not survive 20 years of free communication with the West of Europe . . . .[2]

Now the régime of Nicholas I did not really need to make its own inability to stand comparisons a reason to try to tear down all that existed, that was different, outside its own borders, nor did it have the wherewithal to attempt anything so ambitious. Today, for various reasons, there is apparently a feeling of need on the part of the successors to Nicholas I to eliminate unpleasant standards of comparison and to create conditions in which dictatorship can pursue its own peculiar processes in its own wasteful way, unhampered by the embarrassing proximity of a freer life, capable of deflecting people's thoughts and dreams from the dictates of established authority—capable of keeping alive in people's hearts the flickering flame of hope for release from human bondage.

The logic of this is that we cannot view with the same impassive equanimity as Adams did the advance of what was called in Monroe's message "the political system" of other Powers. The Powers then referred to were the arrogant and imperious courts of Europe, animated at the worst by an amused contempt for the struggling frontier Republic on the western shores of the Atlantic—dangerous to it mainly in so far as their colonial rapaciousness, or what appeared to Americans of that day as their colonial rapaciousness, might cause them to make out of

[2] *Letters de Russie*, by the Marquis de Custine (Editions de la Nouvelle France, Paris).

the new world a battleground of their conflicting greeds and interests, thus crowding our young Republic on the continent of its residence or drawing it into needless and dangerous conflict.

Today it is a grimmer type of political system which faces us across the world and with the expansion of which we are concerned. It is one directed at the vitals of our power and our faith. We can no longer be so fastidious, or so restricted geographically, in our opposition to it, as were the men of Adams' time in facing the problem of their day. There are times when we must obviously move to support the efforts of others to resist attempts made to bring them into subjection to such a political system.

For it is by a program of progressive subjection, one by one, of other peoples who live between ourselves and the seat of world communism, that our adversaries believe our world can best be undermined and we ourselves best reduced to a position of helplessness and loneliness and ignominy among the nations of mankind. To help others who are thus threatened is therefore a duty, not to our national interests in the narrow sense, but, as we believe, to an enlightened concept of our responsibility as a leading world Power—to a belief, which we hold to be deeply creditable to our people, that our security lies in the preservation of balance and stability and confidence among the nations of the world in general.

We recognize, therefore, the necessity of engaging ourselves more directly in the affairs of many peoples far from our own shores than our forefathers would have been inclined to approve. And it is clear that this engagement must in most instances take the form of assistance to them, sometimes economic, sometimes other than economic, in the pursuit of certain of their own programs and activities. For the alternatives to this would be direct, independent intervention in the affairs of others which would run counter to the feelings of the peoples concerned and to the purposes of their legitimate governments, and we continue to have strong feelings about the impropriety of such intervention. Where we do engage ourselves in the affairs of others, we try to see that this is by way of assistance to others in efforts which they themselves wish to make in their own interest.

It is clear, then, that the extension of aid to others does find justification by principle in the structure of our foreign policy.

This does not mean, however, that there are not important qualifications on the conditions in which such aid can be warranted and on the results which we can expect it to produce. It is precisely on this subject, on the subject of the necessary limitations and qualifications of foreign aid as a device for the implementation of foreign policy, that there is greatest confusion and uncertainty in the public mind. Let us see what we can do to clear up some of the most common misconceptions.

Foreign aid, first of all, is not some sort of patent remedy. It is not an independent and fool-proof device, guaranteed to have universal validity and to produce certain calculable results in any and all conditions. Its efficacy is determined by the context in which it is extended and by the wisdom with which it is applied. Since no two situations are alike, there is a simple lack of logic in the voices which tell us that we should have some uniform pattern of foreign aid, and demand of our government that it do some particular thing in one area just because it did something comparable somewhere else. There is nothing absolute or automatic about foreign aid. To attempt to standardize its application would not be consistency—it would be applied fallacy.

What do we have to take into account in determining whether we have a suitable context for the extension of some special form of governmental aid to another people?

What are the elements of a suitable context?

First, there is the question of purpose. John Quincy Adams pointed out that the motives of people are apt to be mixed, and that even when the resistance to foreign oppression may occupy a leading part among those motives, other things, such as interest and intrigue, individual avarice, envy and ambition, may also find a place and may even " assume the colors and usurp the standard of freedom ". We cannot undertake to dissect the political personalities of foreign peoples and to identify the component parts of what constitutes their interpretation of their national interest. Accordingly, we cannot afford, as our forefathers correctly observed, to put ourselves into a position of sponsorship for *all* the motives of other governments just because we find it fit to support *some* of their actions. When we set out to help others, we must be acting upon our own analysis of the probable results of the undertakings to which

our aid is addressed. For the actual consequences of what we do, we have to take responsibility, as mature people, before our own and world opinion. But we must be careful not to accept responsibility for all the motives and aspirations of all those to the support of whose efforts our aid may be directed or those who may profit in one way or another from it. Our task is to satisfy ourselves, before we begin to help others, that the results of our action can be expected to be ones beneficial to causes for which we ourselves are not ashamed to stand.

Second, we have to take into account the degree of resolution and vigor of purpose which lie behind the efforts of those whom we are aiding. When we set out to help other governments in something they are trying to accomplish, we must always reckon that our aid can be only relative, and relative only in a marginal sense, to the efforts they themselves may make. It can have no absolute value in itself. If their efforts are perfunctory or inefficient or fainthearted, our aid to them can scarcely be otherwise.

Above all, our will cannot replace their will. There is a natural danger that aid given to others in undertakings which represent only the discharge of their normal responsibilities to themselves can lead to overreliance on that aid, and to a weakening rather than a strengthening of the fiber of independent action. Wherever this begins to happen we are on dangerous ground. It might almost be stated as axiomatic that where people make the receipt or nonreceipt of aid from us the criterion of their own efforts—where they say " Unless you aid us we will not aid ourselves "—we can conclude that our aid would be certainly misdirected and unlikely to serve any useful purpose. Unlike our Communist adversaries, we have no desire to infuse into others a foreign will to the exclusion of their own. We have no desire to give the appearance of animation and vitality to what are in reality limp and lifeless puppets. Being free men ourselves, it is in the company of free men that we would wish to move. We must be careful that the use of our great strength, by way of assistance to others, does not place us in the position of being their debauchers rather than their helpers.

Third, we must take account, in determining upon measures of foreign aid, of the considerations of economy in the allo-

cation of our own energies and resources. The problems of this world are deeper, more involved, and more stubborn than many of us realize. The limitations on what this nation, or any other single nation, can accomplish with that margin of its energies and material production which it can afford to devote to outside affairs are greater than we are often inclined to remember. It is imperative, therefore, that we economize with our limited resources and that we apply them where we feel that they will do the most good. This means a system of priorities. It means the establishment of certain categories of needs to which we will be able to respond less promptly and less fully than to others. For this reason, it cannot always be assumed that failure of this country to aid a cause which someone feels should be aided is the result of some inconsistency of policy or of a failure to have any global policy at all. No global policy which has reality in deeds as well as in words can fail to be primarily a policy of priorities—a policy of a wise economy in the use of our own strength. And no such policy can be all things to all men.

So much for the limitations of foreign aid as an instrument of our foreign policy. Now a word about that concept which regards aid to other countries as some sort of an act of charity, or as a letter of credit on which we should henceforth be able to draw in any and all problems of international life.

So far as the concept of charity is concerned, I would say that it would reflect not only great ignorance and superficiality but also a certain impropriety on our part to expect assistance granted by this government to other governments, in the deliberate promulgation of our own foreign policy, to be regarded as an act of charity, deserving of a spirit of grateful and sentimental obligation on the part of others. Governments are not individuals, and cannot be expected to act like individuals. Their duty is not to themselves but to the interests of their respective peoples. Alexander Hamilton pointed out in the *Federalist* papers that, while " Faith and justice between nations are virtues of a nature the most necessary and sacred ", the same could not be said of gratitude.

> . . . Between individuals [he wrote] occasion is not unfrequently given for the exercise of gratitude . . . . But among nations . . . such occasions . . . perhaps never occur. It may be affirmed as a general principle, that the predominant motive

> of good offices from one nation to another, is the interest or advantage of the nation which performs them . . . . an individual may on numerous occasions meritoriously indulge the emotions of generosity and benevolence, not only without an eye to, or even at the expense of, his own interest. But a government can rarely, if at all, be justifiable in pursuing a similar course . . . .
>
> . . . It is not here meant [Hamilton continued] to recommend a policy absolutely selfish or interested in nations; but to show, that a policy regulated by their own interest, as far as justice and good faith permit, is, and ought to be, their prevailing one: and that either to ascribe to them a different principle of action, or to deduce from the supposition of it, arguments for a self-denying and self-sacrificing gratitude on the part of a nation, which may have received from another good offices, is to misrepresent or misconceive what usually are, and ought to be, the springs of national conduct . . . .[3]

I am sure that these words of Hamilton are sound. In granting aid to others we must bear carefully in mind that each of us is the guardian of his own interest and we must not expect to be the objects in future of sentiments and manifestations of gratitude in which no other government can properly indulge. This does not apply to pure acts of charity which emanate from private individuals in our country, such as the assistance we have so often extended to others in times of disaster and suffering. It does apply to these measures of our government which are great and deliberate acts of state, taken with due regard to, and in pursuit of, a careful appraisal of the interest of our own country.

The same principles serve as the answer to those who would regard foreign aid as a sort of an unlimited letter of credit, to be held by us, upon the future policies of other governments in any and all matters, whether related or otherwise to the immediate purpose of our aid. We have seen that when we give aid to others, it should be because we have decided that the undertakings we are setting out to support are worthy ones from the standpoint of our national purposes. In the success of these undertakings lies our reward; we should seek no other. If we do not consider this reward sufficient, the aid should not be extended, or it should not be considered as aid. If our desire is

[3] *The Federalist*, Appendix, 1818 Edition, "The Letters of Pacificus", No. IV, by Alexander Hamilton, pp. 573-575.

to receive consideration from another nation with respect to policies which it may adopt in future, in the conduct of its own affairs, this should be regarded, not as aid, but as an international transaction, clearly spelled out and understood by both parties. It would be better to extend no aid at all to others than to have any unclarity or misunderstanding on this point.

It is clear from the nature of the world situation we see before us that foreign aid is a valuable and indispensable instrument of our foreign policy at this stage in our national development. Without it, a whole series of friendly peoples, overtaken in the wake of this recent war by abnormal strains and abnormal weaknesses, would have found it hard to maintain their national traditions, and perhaps even their independence. In the light of what I have said, however, I think you will all agree that foreign aid is an instrument which should be used with great circumspection. Used unwisely, capriciously or without regard to its inherent limitations, it can bring more harm than good not only to others but to ourselves as well, and to the whole structure of our foreign relations.

Our problem here, it seems to me, is to learn to utilize with wisdom and discretion that formidable margin of surplus energy and material values which our nation has shown itself capable of producing, and, one might almost say, incapable of not producing. Any disposal of this margin is pregnant with significance for the course of international events. Our power of disposition over it is therefore a grave responsibility for us all. This is part of our problem of growing up in the space of a few years from the youthful independence of a remote frontier community to the vast and humbling responsibilities of world leadership.

In the utilization of this instrument of foreign aid, as in the implementation of all other methods for projecting our strength and our spirit beyond our borders, we have great need to preserve our sense of proportion and of the fitness of things. In cases of doubt, in cases where we are not too sure of our ground and not too well fortified by study and experience, let us not get too far from the simple wisdom of our forefathers, so well expressed in the passages I have cited to you this evening.

(Applause)

Remarks

CHAIRMAN LAMONT: Thank you, Mr. Kennan, for your thoughtful, wise and scholarly address. Now we shall hear of the European Recovery Program from the man who runs it. I want to say a word about it first. Our European Recovery Program has bought time for the peoples of Europe and the United States. How has that time been utilized?

In 1947, the trade and industry of Europe were recovering at a snail's pace. There was very little political stability in some of the nations; France and Italy, for example. The political power of the Communist elements in those nations was great, and there was a pervading fear of the advances of communism from within and from without. But now trade and industry are active. In a quantitative sense, at least, production has recovered; and, while in 1952 there may remain a dollar deficit in the trade of Western Europe, nevertheless substantial economic gains will have been realized.

More important: hope, reassurance, a stronger feeling of security, a diminishing fear of communism, have come to its peoples. Moreover, in the time which E.R.P. has bought for us, there has begun to grow in this country a realization that we must alter our political thinking and our economic actions and policies from those appropriate to a debtor country to those of a creditor nation, a nation that has become the hugely predominating influence in the world's economy.

Through E.C.A.'s operations and by Paul Hoffman's own forceful and suggestive observations, public opinion here and abroad is waking up to these new concepts.

Paul Hoffman came up the hard way too—to the leadership of the Studebaker Corporation—and he proved that a company does not have to be gigantic to compete successfully with giants. He ran a very good show there, and it still runs well even though he is absent, which I think speaks well for his ability in picking men. And on that subject of picking men, I want to read a letter I had from a friend. He writes:

> I had a chance to see ECA's operations in many countries this summer. Some businessmen have said that it has too many bureaucrats, but if they themselves had recruited its personnel, they would have ended up with no better or more capable staff than Paul Hoffman's. Planning has been well done and controls seem reasonable and workable. Our ECA is well operated.

I value that opinion especially because it comes not from one of us softheaded international do-gooders of Wall Street, as some of our

Chicago friends occasionally call us, but from a hard-boiled, hard-headed Chicago industrialist who practically every morning of his life glues his eyes to the *Chicago Tribune*. (Laughter)

It was during the early years of the war that Paul Hoffman first became a national figure. He had a shrewd worry that American business men, in their great war effort, might overlook the difficulties which would confront us all when the war ended. He felt it only prudent to prepare for post-war reconversion. So the Committee for Economic Development (C.E.D.) was started. Mr. Hoffman knocked on the doors of a thousand corporations, even the bankers, soliciting their support in funds and in the loan of good men; and he borrowed good men also from our universities—many of them here tonight—who brought their fine talents to bear upon the reconversion problems. Business men and economists worked together; business men learned from the economists, and I hope even occasionally vice versa! Their joint efforts exerted a powerful influence on the policies of our government and helped to bring about the successful transition of our country from war to peace.

As I looked through some old clippings about Paul Hoffman, I ran across one unusual discrepancy. *Business Week* said he played golf in the high nineties, whereas *Life* said that he shot his golf in the low eighties, that that was his normal score. This indication that Paul Hoffman boasted to one of Harry Luce's reporters in the only evidence I have found of immodesty in this extraordinarily modest man.

(Laughter)

Mr. Hoffman has just returned from Europe where he has been wrestling with a host of problems, and talking, in his usual candid fashion, with the foreign and finance ministers of the E.C.A.-participating nations. Those men know, as we know, that once again Paul Hoffman has done a magnificent organizational job, that he has administered the largest, most difficult, most complicated selling and distribution operation in the history of the world, all with superlative skill throughout, with selfless energy and a disinterested nobility of motives that make us all very proud of him as an American. Mr. Paul Hoffman! (Applause)

Mr. Paul Hoffman: Mr. Chairman, Members of the Academy of Political Science and Ladies and Gentlemen: Mr. Chairman, you have overpraised me. That, I enjoyed thoroughly. I think you underpraised George Kennan, and I would like to say just this added word. Everyone in government, from the President down, has complete respect for George Kennan. There is no one who influences foreign policy more, or whose words and views are more respected.

(Applause)

TRADE RESTRICTIONS—AND PEACE

PAUL G. HOFFMAN
Administrator, The Economic Cooperation Administration

THE European Recovery Program as originally designed envisaged as its end-product a Europe whose productivity should be so increased and whose economy should be so reconstructed that it would be self-supporting and require no further extraordinary outside assistance. The design has not changed. The originally planned end-product is still what we expect—and great progress has already been made in Europe toward achieving it.

That progress has been made by the Europeans with our help. Let us remember that. No one, certainly not I, would ever have dared predict a year and a half ago that Europe would be where it is today. If you will recall where Russia was in Europe two years ago and where Russia is today, I think you will realize the significance of that progress. (Applause)

In a way the fire-fighting phase of this undertaking is behind us. If further progress is to be made, it calls for a shift of emphasis in our recovery program. That involves an understanding of the baneful—even terrifying—effects of the restrictions which the Europeans themselves placed on intra-European trade and commerce during the last half-century. These effects are so clearly visible that their implications cannot be overlooked by even the most ardent advocate of high protection for America's industries.

Until the turn of the century Europe was the undisputed center of world trade and commerce. The conditions in which Europe's modern economy grew great were a substantially free trade throughout Europe, a free movement of labor, and a substantially free movement of capital. Because Europe was in effect a single market, within the limits of the then-existing knowledge and techniques, full use was being made of Europe's resources. Competition exercised a relentless pressure on costs, and stimulated a continuous search for new and more efficient methods of production.

As a consequence of these benign conditions, trade among the countries of Europe and between Europe and the world increased geometrically. Wealth grew so rapidly that European capital flowed out in a great stream to high-yield, productive enterprises throughout the world, stimulating still further demand for European manufactures. And with minor exceptions, there was real peace among nations.

For fifty years, Europe has been in the process, little by little, of destroying these conditions of its economic greatness. The breakdown of the European security system that accompanied the rise of German power late in the last century drove the nations of Europe to increasing political and economic nationalism. This nationalism was intensified after the First World War, as each nation sought to solve the problems of economic reconstruction along lines of national self-sufficiency. Tariff barriers were raised to heights theretofore unknown.

Then came the world depression, and, instead of attacking the problem of growing poverty by coöperative measures, each nation in Europe tried to solve it by beggaring its neighbor. Tariffs were no longer sufficient. The *absolute* trade restriction came into being in the form of import quotas and exchange controls. Let me say that the man who invented tariffs was just an amateur compared with the man who invented import quotas and exchange controls. These rigidly determined the amounts of goods that could move in international trade, and sharply reduced the influence of the competitive process on the flow of trade.

During the Second World War the tools of peacetime nationalism were converted to instruments of economic warfare; and after the end of hostilities, they remained instruments of economic warfare in the service of nationalism.

The situation after the first stage of recovery following the recent war reached the point of ultimate absurdity. For example, Italy had a surplus of textiles and needed wood pulp and other wood products. Sweden had a surplus of wood products and needed textiles. But quotas and exchange controls obstructed the adequate satisfaction of these wants through trade. Similarly Denmark had a surplus of dairy products and needed metals manufactures. Western Germany needed dairy

products and had manufactures to export to Denmark. The satisfaction of these wants and needs was prevented by trade and exchange controls.

These examples could be multiplied by thousands. Fifty years of growing protectionism by nationalistic devices had finally almost completely fouled the lines of trade and obstructed the channels through which the people of Europe could satisfy their needs. Trade restriction had long since gone beyond the point of merely denying consumers the cheapest and most efficiently produced goods. It had got to the point of denying them goods they needed *at any price.*

This strangulation of intra-European trade over a long period practically eliminated competition in Europe's basic industries, thereby destroying a fundamental condition of increasing productivity. It caused a deficient and inefficient use of Europe's resources. And finally, it provided a barrier behind which an aggressor twice prepared for war against its neighbors.

Let us consider each of these consequences of trade restriction in Europe and its effects upon Europe's economic position in the world.

Europe's basic economic problem today is often described as the " dollar shortage ". That is to say, Europe is unable to sell enough of its products in the United States and other non-European countries to pay for what it must buy from those countries in order to maintain a decent standard of living. We are just now fully realizing that Europe's inability to compete in the world today is due in large part to the fact that increasingly for fifty years European producers have been freed from the necessity of competing in their own home markets. Trade restrictions have more and more removed the pressure of foreign competition.

Behind trade barriers, basic industries in small national economies have not found it difficult to eliminate internal competition. Restrictions on trade among the European nations have therefore resulted not only in the elimination of competition *between* countries in such basic industries as steel, coal and chemicals, but in the softening of competition *within* those countries. Furthermore, competition for these industries in the

export field has all but been eradicated by the formation of international cartels.

Theoretically, of course, internal competition could prevail within a country even though competition from without were barred. Actually, the maintenance of effective competition in any one of the units of the highly compartmentalized European economy would be most difficult because of smallness of size even if there were anti-trust laws. In the absence of anti-trust laws, internal competition has been almost nonexistent. In the absence of such laws, business managements quite understandably have gotten together, fixed prices, and divided markets. I say " quite understandably " because no one really likes competition. It is not a comfortable way of life because it requires hard thinking on the part of business managers if they are to stay in business, and hard thinking is indulged in by most of us only when under great pressure. (George Kennan is excepted, of course. But I know in my own case when I was a corporation president and a really tough problem came to my desk, my first instinctive reaction was to try to think of the vice-president to whom I could pass it, and, as a bureaucrat, the only difference is that I now try to think of some deputy to whom I can hand it.)

It is difficult to envision precisely the effect that full and invigorating competition might have had if it had prevailed in the European economy. This we do know—that if freer trade and livelier competition had prevailed, European productivity today would not be, as it is today, less than fifty per cent of that of either the United States or Canada.

With small national economic compartments surrounded by high walls, Europe has also been unable to make the most efficient use of its resources. And by resources I mean not only raw materials but skills and labor supply as well. High-cost raw materials available within a country have had to be used in preference to cheaper ones across the border. Many countries for reasons of national pride or self-sufficiency have embarked upon certain lines of industrial production whereas production capacity in already existing highly efficient plants in still other European countries has remained idle. Italy and Western Germany have a surplus of population. France has a deficiency.

And yet immigration barriers have prevented a flow of labor from a surplus to a deficit area.

The advantages of mass production and of a mass market have thus disappeared, as national economic barriers have risen. The inefficient use of the resources of a continent has caused ever mounting costs. It is small wonder that Europe's ability to compete in dollar markets has declined.

Europe's competitive problem was brought to a crisis by the recent war which destroyed a large part of its productive plant and cost it most of its foreign investments. Economic nationalism directly contributed to the planning and waging of that war. It aided Germany twice in planned aggression against its neighbors and at the same time operated to prevent the rest of the world from uniting in time to discourage attack.

It was only behind absolute trade barriers that Hitler was able to create a synthetic gasoline industry and a synthetic rubber industry. It was only behind the most rigid trade barriers that Hitler was able to convert the German economy from the production of butter to the production of guns. If the European economy had been integrated, with its resources used in the most efficient manner, with trade flowing freely from one unit to another, neither Germany nor any other country would have been able to put itself into a position to sustain an effective attack on its neighbors. Unless the economy of Western Europe is thoroughly integrated now, with the possibility removed that any nation can organize its resources for war, Europe will never be able—just for reasons of security alone—to increase its productivity and its ability to compete abroad. Each nation will be under a relentless pressure to warp its economy to the requirements of military security.

From whatever point of view you look at it, trade restrictions have been the curse of Europe during the last fifty years, and I do not see how Europe will ever find military security or economic well-being until it sweeps those barriers away.

One of the first things the Organization for European Economic Co-operation had to do to get a recovery program started, a little more than a year ago, was to devise emergency measures to revive intra-European trade, for by the summer of 1948 that trade had been reduced to a trickle. An intra-

European payments plan was put into operation. The heart of this plan was the provision of dollars by the E.C.A. to some countries to buy the surpluses of others. This plan had an immediate and highly beneficial effect on intra-European trade and upon European recovery.

It is clear, however, that an intra-European payments scheme based on the provision of dollars from the United States is no permanent solution, for when the dollars stop a great deal of intra-European trade may well stop too.

The European nations represented in O.E.E.C. are well aware of the dimensions and the urgency of the problem of creating permanent arrangements for a large and increasing trade among them. This problem was the chief item on the agenda at the recent meeting of the O.E.E.C. in Paris, which I just attended.

Before meeting with the O.E.E.C. itself I had a series of discussions with far-sighted European leaders, and with our ambassadors in the participating nations, who were at the moment meeting in Paris. I also had long talks with our E.C.A. special representative, Ambassador W. Averell Harriman. (And I might say that on every occasion possible I have had long talks with your President—the President of the Academy of Political Science—the Honorable Lewis Douglas, and if America ever had a better diplomat than Mr. Douglas, I do not know who it was. I saw him just ten days ago, and I am glad to report to you that he seemed to be in very much improved health; in fact, he seemed very much his old self.) (Applause) Growing out of these consultations was the program of action I presented to the O.E.E.C. on October 31, which was designed to stimulate immediate action toward certain definite short-term objectives and toward a long-range goal as well.

We would like to see a grouping of countries such as France, Italy, Belgium and Germany which are complementary economies in a large way, a grouping of the Scandinavian countries which are complementary economies, and pressure between those groups to free up trade. That, we think, is the practical way to reach this goal we set before them.

I suggested first that the participating countries take really effective action by early 1950 to remove quantitative restrictions on trade. I suggested secondly that effective action be taken by

early 1950 to eliminate the unsound practice of double pricing, that is, maintaining export prices for fuel and basic materials at higher levels than domestic prices.

The long-range goal I put before the O.E.E.C. was the effective integration of the economy of Western Europe—the building of a single market of 270 million consumers, in which quantitative restrictions on the movement of goods, monetary barriers to the flow of payments, and eventually all tariffs should be permanently swept away. I advanced this as the only framework in which Europe could begin to become truly self-supporting, and within which Europe could achieve a high and rising standard of living.

We in E.C.A. of course are fully aware of the difficulties involved in creating a single market in Western Europe out of segments long separated. We realize that it cannot be done overnight. Therefore, I pointed out to the O.E.E.C. that as a practical method of working toward the goal of economic integration smaller regional groups of countries might make faster progress toward the same goal.

I suggested that the small groups of countries push ahead in their arrangements for integrating their economies, while keeping ever in mind the necessity of reducing the economic restrictions between groups and moving in a direct line toward the ultimate goal of the economic integration of the whole of Western Europe and its overseas territories. We tried to make it clear that this was not an ideal that we were putting before them, something to be thought about in the ivory towers, but a very practical necessity.

The O.E.E.C. accepted the suggestions that were offered and embodied them in a resolution recommending action by the participating countries. There is no magic in resolutions, of course, and I so pointed out in a final talk to the O.E.E.C. What is needed is immediate action on short-range objectives and the immediate formulation of realistic plans for action toward the larger goal.

I am confident that we will see quick action within the next few weeks that will accomplish the short-term objectives that I presented to the O.E.E.C. I also have high hopes for early and rapid progress toward the longer-range goal of European inte-

gration. I say that, realizing that it can come about only as a consequence of inspired leadership by the Europeans themselves. Europe must itself produce leaders, the methods and the institutions that will make a new continent in Western Europe out of an assemblage of gallant but economically strangled nations.

I am confident that, just as grave crises have in the past brought to the forefront leaders, plans and solutions, so now, in this crisis of European and Western civilization, Europe will not disappoint man's faith. (Applause)

REMARKS BY THE CHAIRMAN

CHAIRMAN LAMONT: The members of the Academy will be interested to know perhaps that, through this little instrument, these addresses of our two distinguished guests have been recorded for broadcast throughout the world on the " Voice of America ".

Lew Douglas in his cable congratulated us upon what we were to hear. I shall reply that his congratulations were justified. The meeting is adjourned. (Applause)

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